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S. HRG. 105-389

THE MULTIFAMILY ASSISTED HOUSING REFORM AND AFFORDABILITY ACT OF 1997—S. 513

P70-3

HEARING

BEFORE THE

SUBCOMMITTEE ON HOUSING OPPORTUNITY AND COMMUNITY DEVELOPMENT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

ON

S. 513

TO REFORM THE MULTIFAMILY RENTAL ASSISTED HOUSING PROGRAMS OF THE FEDERAL GOVERNMENT, MAINTAIN THE AFFORDABILITY AND AVAILABILITY OF LOW-INCOME HOUSING, AND FOR OTHER PURPOSES

JUNE 17, 1997

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THE MULTIFAMILY ASSISTED HOUSING REFORM AND AFFORDABILITY ACT OF 1997
S. 513

TUESDAY, JUNE 17, 1997

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON HOUSING OPPORTUNITY AND
COMMUNITY DEVELOPMENT,
Washington, DC.

The Subcommittee met at 9:30 a.m., in room SD–538 of the Dirksen Senate Office Building, Senator Connie Mack (Chairman of the Subcommittee) presiding.

OPENING STATEMENT OF SENATOR CONNIE MACK

Senator MACK. It is necessary to get this hearing underway. There are many things going on in the Senate this morning. I am on the Finance Committee and we begin the markup of the Medicare reform and other entitlement reforms this morning. So it is important to get started.

The subject of this hearing is the "Multifamily Assisted Housing Reform and Affordability Act," S. 513, which I introduced on March 21 with Senators D'Amato, Bennett, and Bond. The purpose of this legislation is to restructure the Nation's assisted and insured multifamily housing portfolio in a manner that balances both fiscal and public policy goals.

HUD's Section 8-Assisted and FHA-Insured Multifamily Housing Program has created thousands of decent, safe, and affordable housing properties. However, the current program allows some owners to receive often far more Federal dollars than necessary to maintain their properties.

Further, a portion of the rental stock suffers from poor management or has become physically distressed, thus, in some cases, taxpayers are paying costly subsidies for inferior housing.

In the next several years, the majority of the project-based Section 8 contracts on the 8,500 FHA-insured properties will expire. If contracts continued to be renewed at existing levels, the cost to renew them will grow from about $1.7 billion in the current year to almost $4 billion in fiscal year 2000, and $8 billion in 10 years.

The total cost of renewing all Section 8 contracts will grow from $3.6 billion this year, to more than $9 billion in 1998, and as much as $18 billion in fiscal year 2002.

If these project-based contracts are not renewed, residents in many communities will be adversely affected, and most of the FHA-

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insured mortgages with an unpaid principal balance of $18 billion will be forced into default.

HUD's Secretary Cuomo has called the Section 8 renewal crisis the most serious problem facing his Department. The fiscal year 1998 Budget Resolution, while projecting the renewal of Section 8 contracts over the next 5 years, assumes the enactment of legislation to reduce excessive subsidy levels on expiring Section 8 contracts. Thus, there is broad agreement that maintaining the status quo is no longer possible.

The Subcommittee held its first hearing on what is commonly referred to as the mark-to-market issue, almost exactly 2 years ago. Since that hearing, we have gotten extensive input from all the potential stakeholders in this matter, including project owners and managers, low-income advocates and project residents, State and local interests, the financial community, and HUD.

S. 513 represents what the Subcommittee believes to be a bipartisan, consensus approach that treats all interests fairly. The reforms contained in S. 513 are critical to ensure that the residents, the communities, and the Federal investment in this housing are protected at a reasonable cost. This bill attempts to deal not only with the budget issues, but the public policy questions as well. S. 513 contains several key features which I will mention briefly:

First, it marks rents on over-subsidized properties to comparable market rents or to 90 percent of area Fair Market Rents. The underlying mortgages would be restructured so that they could be supported by the new rents. In some cases, higher rents could be permitted, up to 120 percent of Fair Market Rents, if necessary to support the proper operations and maintenance costs.

Second, where feasible, the functions and responsibilities of the restructuring process would be transferred to capable State and local housing finance agencies. Those agencies would act as Participating Administrative Entities in managing this program and monitoring the portfolio after restructuring.

Third, S. 513 would screen out from the restructuring process, noncompliant owners and managers, and nonviable from the inventory. It also provides tougher and more effective enforcement tools that will minimize the fraud and abuse of HUD's insurance and assisted-housing programs. And where necessary, alternative housing such as tenant-based assistance would be provided to affected residents.

Fourth, to ensure that portfolio restructuring does not adversely affect the local residents or communities in which the properties are located, all affected parties would be consulted in the restructuring process. Residents would be further empowered through opportunities to purchase properties.

I want to thank my colleagues, in particular, Senators D'Amato, Bond, Bennett, Sarbanes, and Kerry, for their cooperation and support during the development of S. 513.

I also want to thank all of the organizations that have worked with the Subcommittee over the past 2 years. I sincerely regret we could not accommodate all of the groups who had requested the opportunity to testify.

Given the urgency of the Section 8 renewal problem, and the fact that this legislation will achieve significant budget savings, it is

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our intention to include the text of S. 513 in the Banking Committee's Budget Reconciliation Bill which will be voted on by the Full Committee tomorrow.

I hope that Secretary Cuomo will today express the Administration's support for seizing the opportunity to move this process forward through reconciliation. Delays in enacting a mark-to-market bill will only harm the assisted-housing stock, residents, and communities.

This morning, we have eight witnesses, HUD's Secretary Andrew Cuomo, The Honorable Tommy Thompson, Governor of Wisconsin, and a panel of six witnesses representing various stakeholders in this process.

Before turning to other Members of the Subcommittee, I would ask unanimous consent that several letters in general support of S. 513 be included in the record.

Since there is no objection, we will include them in the record. Senator Reed.

OPENING COMMENTS OF SENATOR JACK REED

Senator REED. Thank you, Mr. Chairman.

I would like to first commend you for your work on this very important legislative initiative. Today represents an excellent opportunity to explore some of the details of the legislation in anticipation, I hope, of swift passage.

The problems currently facing the Section 8 program are the result of decisions that were made 20 years ago when HUD started the Section 8 New Construction and Substantial Rehabilitation Program to create additional affordable housing.

In many cases, the cost of construction, interest rates, energy costs, and other factors made it impossible to pay for the housing by charging market rates. As a result, the subsidy in 90 percent of the new construction units was greater than the market rent, thereby substantially increasing the costs of the Section 8 program.

Also, the length of most of these Section 8 contracts was 20 years, while the terms of the underlying FHA-insured mortgage was 40 years. Today, we face a situation in which many of these Section 8 contracts are expiring, and unless the contracts are renewed, 80 percent of the owners will not be able to pay their mortgages and run the housing complexes.

However, since these projects are FHA-insured, failing to renew the contracts would create a $10 billion liability for the FHA. S. 513, which the Chairman has drafted, is intended to address these problems.

Specifically, the bill will allow owners of qualified properties to restructure their mortgages in order to reduce their rents and the Section 8 subsidies paid to them by HUD. The bill will also ensure the renewal of Section 8 contracts for the length of the mortgage, thereby preserving existing units of affordable housing. In addition, S. 513 includes provisions that will enhance the ability of HUD to bar questionable owners from HUD's assistance programs.

I applaud the Chairman's work in producing this comprehensive legislation which tackles the difficult issues facing the Section 8 program. I understand that this legislation is the result of 2 years of work between this Subcommittee's staff and the various stake-

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holders: HUD, landlords, tenant groups, and State housing finance agencies.

The resolution of the problems facing the Section 8 program are of great importance to my home State of Rhode Island which has a large number of Section 8 housing units. In the next 2 years, it is anticipated that approximately 4,000 project-based Section 8 subsidies will expire.

My number one priority is to see that these expiring contracts are fully extended and renewed, and that no one who currently lives in this housing will lose their housing.

In conclusion, I am look forward to working with the Chairman to see that we preserve existing Section 8 housing, and that we make the necessary reforms to ensure the viability of this program into the future.

Not only do I welcome Secretary Cuomo, but also Assistant Secretary Retsinas, who is a dear friend from Rhode Island.

I thank you, Mr. Chairman.

Senator MACK. Thank you for your statement.

Senator Allard.

OPENING COMMENTS OF SENATOR WAYNE ALLARD

Senator ALLARD. Thank you, Mr. Chairman.

First of all, I would like to thank you for your hard work on the housing issues. I think you are working hard to bring about real reform. I realize that you have to work under certain parameters of restraint within the process. I particularly want to thank you, Mr. Chairman, for conducting this hearing and in addressing the Section 8 portfolio of re-engineering proposals. I would also like to thank the witnesses for taking the time to testify today before this Subcommittee.

I, for one, certainly recognize the complexity of this issue, and I realize the need for reforming Section 8 subsidy programs. I have always felt that we would be better off here in Washington if we did less subsidizing of business.

I worked on the Agriculture Committee in the House, and we began to move the agriculture producers and the farmers off of subsidies, and I think we have to look at other sectors of the economy where we do subsidize business. This is one area that I think we need to spend more time with.

I happen to be a strong proponent of vouchers, and relying more on the market system to select winners and losers, instead of running it through some sort of Government bureaucracy. So I do have those concerns as we move through the system.

But I also realize that this is part of the reconciliation process, and it is something that we need to do to meet the agreement that is in the Budget between the House and the Senate. I realize that although there is some reform in here, it is only temporary in nature, and that much, much more needs to be done. If we look 5 or 10 years down the road, we will still be having many of the same problems that we have today. I am going to support the Chairman because this is part of the Budget agreement. But I will continue to push at every opportunity to bring about real reform on housing issues.

Thank you, Mr. Chairman.

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Senator MACK. Thank you, Senator Allard.
I will now turn to Senator D'Amato.

OPENING STATEMENT OF SENATOR ALFONSE M. D'AMATO

The CHAIRMAN. Thank you, Mr. Chairman. It is really good to see Secretary Cuomo here.

Mr. Chairman, we are at an awfully important point in attempting to deal with the problems of Section 8 housing. And I want to commend you for your efforts. We have worked very hard in the spirit of bipartisanship to come to this point. I dare say, I believe that the majority of our colleagues on both sides of the aisle are supportive of your effort, the efforts that have culminated in S. 513.

It is truly a bipartisan consensus bill that represents the culmination of more than 2 years of information-sharing, negotiations, and compromise between a whole range of people: tenants, owners, and various housing groups.

I have here a list of the organizations who support S. 513. It is a very, very impressive list. I will not take time to read all of the names, but it represents the New York Housing Conference, tenants from Massachusetts, the National Alliance of HUD Tenants, the National Association of Realtors, the National Association of Home Builders, and some nonprofit and neighborhood coalitions. It is the entire spectrum; it is not one against the other, which oftentimes we see take place.

We have a tremendous problem. I want to commend the President, and I want to commend you, Mr. Secretary, for your advocacy in dealing with the immediate crisis that is critical in terms of a sufficient allocation of funds and resources and budget authority.

If you look at the chart, we go from $3.6 billion to $10.2 billion. Where do you get that kind of money, $7 billion over and above?

You would have had tremendous, incredible chaos were it not included in the budget agreement, and the leaders of the Congress, along with the President should be commended because they made $35 billion available. That takes care of this year. What do we do in fiscal year 1999, next year, and the following years? We see that it still continues to grow. We go from $3.6 to $10.2. Then we take it from $10.2 up to $16 billion. We cannot afford, I do not think, to continue to play Russian roulette with this kind of growth in budgetary costs.

That is why I thank these people who are the experts—the best who came together to support the efforts of our Subcommittee Chairman, Senator Mack, who has done such an outstanding job in bringing us to this point, with a broad-based coalition of support.

Why am I taking the time of the Subcommittee? I hope I am not imposing unduly. Because the inclusion of S. 513 in the Subcommittee's Reconciliation package, I believe, is important. It will allow us to exceed the Subcommittee's savings target of $1.59 billion, mandated by the Budget Committee, and contribute even further to our efforts to reduce the deficit.

I believe it may be the last ship leaving port for us to be able to accomplish this, and to deal with this crisis. We believe that we will save by this mark-to-market legislation approximately a billion dollars. That is a lot of money. That does not solve the whole problem, but it begins to move us forward in the right direction. I have

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to say that if we do not move forward in Budget Reconciliation, it may never come to pass and we will lose that opportunity.

That is why it is not in the spirit of confrontation, but rather in the spirit of setting forth what I believe to be the overwhelming consensus of this Subcommittee and the professional staff and the people who have been working at this.

And so I would urge, Mr. Secretary, that we attempt to work together in a bipartisan manner. We have just received a letter from Budget Committee Chairman Domenici, asking to co-sponsor this legislation. I am not going to read it all, but I will summarize it by saying he is very happy to co-sponsor S. 513. He looks forward to working with us on this.

So, this may be the last and best ship that we have. I am going to ask that this letter be included in the record, Mr. Chairman as if read in its entirety.

Senator MACK. Without objection.

The CHAIRMAN. Mr. Secretary, let me leave you with just this one final thought. If you have some suggestion as it relates to how we can make S. 513 better, or deal with some of the concerns—I make this offer not having consulted with the Chairman but knowing the manner in which he has come to this point—that we are ready and willing to receive them.

This is not pride of authorship. It just does not exist here. If we can make this a better bill, we are out to do that. So I would hope that in the days that we have before we move forward, we are still here and ready to receive suggestions as to how we can improve it.

I thank the Chair, and again I want to congratulate him for an outstanding effort.

Senator MACK. Thank you for your comments, Senator D'Amato, and I appreciate your kind words with respect to the efforts that this Subcommittee has made.

I turn now to Senator Enzi.

OPENING COMMENT OF SENATOR MICHAEL B. ENZI

Senator ENZI. Mr. Chairman, I thank you for holding this hearing, and I would just ask unanimous consent that my statement be included in the record.

Senator MACK. Without objection.

Senator Faircloth.

OPENING COMMENTS OF SENATOR LAUCH FAIRCLOTH

Senator FAIRCLOTH. Thank you, Mr. Chairman.

I thank you for putting together this legislation to deal with the Section 8 crisis. It is a crisis. With about $18 billion that will be needed by the year 2002, this is the biggest housing issue, and one of the bigger budget issues facing the Congress.

As we all know, the cost of this assistance is spiraling and has been spiraling out of control. We have found that coupling huge subsidies with FHA insurance is disastrous.

The Federal Government is on the line for billions and billions of dollars, whether we renew the contracts or let them go into default. I cannot imagine one particle of good business sense involved in a setup in which you lend a person the money to build a house or build a series of apartments, and then guarantee them that

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their rent is going to be paid with no default. I mean, they have nothing to lose, the people that built these houses, not one earthly thing. It is just another example of the Federal Government intervening too much in the private market.

As long as the Federal Government continues to get involved in the private market, we are going to have the same problem. The Federal Government and HUD cannot employ enough people. The 11,000 that we already have in HUD is not beginning to be enough to look at all the problems we are going to create if we keep moving in this direction.

Mr. Chairman and Senator D'Amato, I enthusiastically support the bill. You asked Secretary Cuomo to make recommendations to make it better. I certainly hope he has some to make it a tighter, harder bill than it would be as it stands.

I thank you.

Senator MACK. Thank you, Senator Faircloth.

Mr. Secretary, before I ask you for your opening statement, I want to ask you a question. We read through the testimony that you submitted last night. I am assuming that it is basically the same as was submitted. I could not really draw a conclusion from the written testimony as to whether you are in a position to recommend support for going forward and putting this proposal into Reconciliation. I wonder if you could indicate whether you are going to support us moving forward and placing this legislation into the Reconciliation Bill?

Secretary CUOMO. Well, Mr. Chairman, I would be in agreement with the sentiment expressed by the Subcommittee, which is the priority for the Department. It is what we have focused on for the past few months, consistently, legislation, budget, management, all coming back to this Section 8 crisis.

I think it is important that the process goes forward. At the same time, Senator D'Amato's point about do we have recommendations to make the bill a better bill; we certainly do. And we look forward to discussing and making those recommendations and having discussions with you.

Senator MACK. Very good. If you would then go ahead and proceed with your testimony.

OPENING STATEMENT OF ANDREW M. CUOMO, SECRETARY U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Secretary CUOMO. Mr. Chairman, let me take the opportunity first to introduce the senior HUD staff who are here with us today. Assistant Secretary Nicolas Retsinas, Assistant Secretary Michael Stegman, Assistant Secretary for Congressional Affairs Hal DeCell, and Stephanie Smith.

I would ask, if there is no objection by the Subcommittee, that Assistant Secretary Retsinas and Assistant Secretary Stegman join me at the table.

Senator MACK. Certainly.

Secretary CUOMO. Chairman Mack, Chairman D'Amato, Ranking Member Sarbanes, it is good to see you, and Members of the Subcommittee. Thank you for the invitation to be here today, and, moreover, thank you for all the good work that we have been doing thus far together. It really has been a good, cooperative, bipartisan

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relationship, and we have done many good things. The future is promising, and I am looking forward to continuing our work.

As we have heard, the Section 8 crisis is the main crisis facing the Department. There are actually three aspects to it.

The first is the cost of the renewals which Senator D'Amato spoke to most effectively; a 30 percent increase in the budget just this year to cover the costs of the renewals. It is getting worse in the outyears. That is what the chart points to.

Now, hopefully in the Balanced Budget Agreement, we have addressed that aspect of the crisis. The Balanced Budget Agreement meets, in our opinion, the financial needs of HUD going forward to cover that cost of renewal.

The second is the waste, fraud, and abuse that is present in many of the projects in the Section 8 portfolio. The Department has been working on that for months. We have a new partnership with the Department of Justice and the Attorney General. We are working with the FBI. We have a new get-tough campaign, more debarments than ever before.

The third aspect is what we call the "out-of-whack" rents where many of the rents that we now pay for these units are in excess of what is the market rent. This means that if a person walked in off the street and wanted to rent an apartment, they would pay one rate; the Government pays more. Why? It is ludicrous. We now, by the legislation that is in place, renew rents at 120 percent of Fair Market Rent, which means by law, we are, essentially, renewing at 120 percent of what the person walking off the street would pay for a comparable apartment. We cannot sustain this position in this time of tight financial resources, not in this era demanding more effective and more efficient Government.

The proposal we are discussing is the so called mark-to-market portfolio re-engineering. This year we call it the Housing 2020 proposal. It would really address those out-of-whack rents as well as reducing the overall cost of renewal.

I commend the Subcommittee for addressing this problem. It is a thorny issue, indeed. The work that the Subcommittee has done is really most promising and has been most productive.

On Senator D'Amato's point about what recommendations we have, they are threefold:

The first recommendation deals with the question of Section 8 vouchers versus project-basing. Your bill, S. 513, calls for 100 percent project-based subsidies, which means the subsidies would continue to run to the owner of the building.

Our position is as follows, Senator: We believe in mixed income as a matter of policy. We believe the best buildings, the best housing developments, the best communities, are communities with mixed income.

If we have learned anything from the past, we have learned that when we concentrate too many poor people in one place, it does not work well. We learned that in public housing, and also in Section 8 housing. The most effective buildings are those buildings with mixed income. One hundred percent project-basing says that the building will be 100 percent low income, ad infinitum, not 90/10, not 80/20, not 70/30, no mix, 100 percent low income.

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We say that if we understand the logic of mixed income, which we do and all support in a bipartisan way, why not allow some vouchers in that building so that people could move. There would be mobility.

Senator Allard's point about using the marketplace, using the vouchers, is fine. But that then speaks against 100 percent project basing. Use the market, allow mobility, allow some people to move out of a building if they so chose. With the voucher, they then get housing and some units in that building to go market rate. That would be mixed income, and we think that is a good thing.

Now, we do not carry it to an extreme. Our proposal does not say 100 percent vouchers. As a matter of fact, our proposal is probably 60 percent project-based, 40 percent vouchers. The Administration's position in the past has been a 100 percent voucher position. We have moderated that position to be about 60/40. If there is one recommendation that we would have to work on with the Administration, it is that.

The second recommendation is on implementation. The Chairman speaks about the use of HFA's, housing finance agencies. To actually make this happen, we would have to do about 5,000 restructurings, 5,000 properties would have to be restructured. That means the landlords would have to come in, the owners would have to come in, and we would have to sit down at a table, do appraisals, run numbers on that building—5,000 transactions. It is a massive undertaking.

We have had a demonstration in place for a couple of years where we are doing some of these transactions, and they are very labor-intensive and very time-intensive.

S. 513 says HUD would have to use HFA's where those housing finance agencies are qualified, and then refers to a different program called Risk Sharing to determine that 33 HFA's are qualified.

We think to handcuff HUD in a position where we have to use HFA's, if HFA's want to do it, is to artificially constrain our ability to run the program. Our bill says, let us use HFA's where they are qualified and where they want to do it, but let us also use other agents, accounting firms, legal firms. In truth, we are going to need all of these devices to complete 5,000 transactions.

The CHAIRMAN. Mr. Secretary, I do not want you to think I do not appreciate the importance of your testimony, but Senator Mack and I have a Finance Committee markup that is going to start momentarily. I look forward to trying to get back to you and to deal with some of these issues that we have mentioned.

I think that it is fair to assume that we are going to be moving forward. I would just simply suggest that we attempt to implement, where we can, the Administration's suggestions. As I said, this is not pride of authorship. This is and has been an open, sharing process. We look forward to working with you. I do not want you to think that I do not appreciate the importance of your testimony and of your being here.

Secretary CUOMO. Thank you very much, Mr. Chairman.

If I might continue, Mr. Chairman, the second point was the use of HFA's. We would say, use them where they are an appropriate vehicle, but not an exclusive vehicle.

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The Inspector General of the Department also has concerns which I would suggest this Subcommittee look at, about the exclusive use of HFA's. So it is a question of degree. Our bill says use HFA's where it works, but also use other mechanisms. S. 513 is more of an exclusive relationship.

The third recommendation we would have is the question of taxation. One of the main differences in our bill between last year and this year is that we had the same scope of the transaction—reduce the rent, reduce the mortgage—but we have never had a definitive way to handle the taxes. And to get owners to come in with the volume that we need them to come in with to make a real difference, they are going to have to know what the tax ramifications of this transaction are.

Now, there has been a suggestion that we could use what is called a soft-second mortgage as the vehicle to handle the taxes. The Administration, as a whole, and the Department of the Treasury has serious doubts about the availability of that tax treatment.

If we cannot use that tax treatment, then the transaction fails. We have spent so much time coming up with a piece of legislation that would work, this year we proposed an additional tax piece of legislation with Secretary Rubin and the Treasury Department. For the first time ever, HUD coupled with Treasury, to do a piece of legislation, because we needed that definitive tax treatment to make sure we could get the 5,000 properties coming in.

Because there were serious questions about how we were doing this in the interim with the so-called soft-second mortgage, the piece of legislation we submitted also has a tax piece of legislation.

Those would be the three areas, Mr. Chairman, the vouchers versus project-basing; the exclusivity on the HFA's; and the tax treatment. But in general—and let me just, in absentia, comment on Chairman D'Amato's point.

We think the process should go forward. We think Reconciliation is a unique opportunity to move this very thorny problem along.

We do have concerns, as you know, Mr. Chairman, on the three issues that I mentioned. We had those concerns last year, we had them in the beginning of the process this year. We have been discussing them. I am confident that reasonable minds working in a bipartisan way that want to get this done can come to terms on those outstanding issues, and I am confident that we can get a bill this year which would be a very, very powerful signal.

As this Subcommittee knows all too well, we have not had an authorizing piece of legislation, I think, it is about 6 years. To be able to do something on this issue, which is one of the toughest, would really make all the difference in the world.

Once again, we thank the Subcommittee for the opportunity to appear before you today.

Senator MACK. Thank you for your testimony and I appreciate your comments with respect to support of moving this legislation forward through the reconciliation process.

I think it is evident that I, along with other Members of the Subcommittee, have, in fact, made every effort to make this a bipartisan effort.

These issues are incredibly difficult, intricate, and it appears to me, given what we went through during the past 2 years in trying

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to move housing legislation, that an issue of this difficulty, the time has come for us to move it forward. I think the comment that you made this morning that you support moving this forward through the reconciliation process is very important.

I will assure you that I will work with you. I would ask you to work with us as well. As you know, we were in until 8:00 o'clock last night wondering where the Administration was going to be on this. That was not particularly helpful to me, given the activities that I have through the remaining part of the week, but I appreciate your comments this morning.

A couple of thoughts with respect to the voucher issue. I think it is unfair to say that 100 percent of our effort is project-based. We are going to have to make vouchers available to those individuals that are going to be displaced as a result of various projects not continuing. We have to find a way to provide housing opportunities for those individuals, and we believe that we will have somewhere between 15 and 20 percent of our effort will be vouchers.

So on that point, we have some disagreement there, but again I think we have indicated in the past a willingness to work with you.

On the tax issue, frankly, I am a little bit surprised. I mean, I commend you for your effectiveness in being able to influence the Secretary of the Treasury. We worked for some 2 years, could not get the Administration to move on the tax issue at all, not one iota. In fact, in essence, they implied that they just would not do it. So it is a little bit surprising now at the final moment to have Treasury say that they are interested in engaging in a discussion on the tax issues, that's number one.

Number two, I think it is evident by the groups that have supported what we are doing here, based on the soft-second concept, that, in fact, the owners believe that they will be able to move forward with this program.

So again, I appreciate your indication of support. I think that there are areas, in fact, where we can work out some of these differences, but I do have differences of point of view with respect to some of the issues that your raised.

Secretary CUOMO. Mr. Chairman, if I might respond quickly?

On the voucher versus project-based, I do not want to have miscommunicated. No doubt that the properties that are not renewed would have to be vouchered out, either because we do not want to renew them or they do not want to renew with us. Many owners may say, thank you, I have had 20 years, I do not want to continue in the program.

Of those buildings that are renewed, your proposal says 100 percent project-based which then, in our opinion, says 100 percent low income in that building. And we are trying to get away from 100 percent low-income buildings. We are trying to get more mixed income. That is what we are trying to do in public housing, break up that concentration of poverty.

Just because we want to continue the contracts does not mean we want to continue the mistakes. In my opinion, one of the mistakes was too high a concentration of poverty in one place. Vouchers would allow you to get some market rate apartments in that building, and that is why we were talking about concentration.

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On the tax issue, the Department of Treasury joined with us in the legislation several months ago by drafting a piece of legislation which provided a tax fix. Treasury was obviously saying implicitly that the existing situation was not effective; otherwise, they would not have had to draft a piece of legislation and go through the effort that they did.

We submitted that legislation, Mr. Chairman, several months back. So I think Treasury's position was clear at that point. If the existing tax treatment was fine, we would not have had to do the piece of legislation which we actually did.

Senator MACK. Senator Allard.

Senator ALLARD. I think, Mr. Chairman, that on the tax issue, it brings in another Committee. I think the Finance Committee would have to deal with that.

Right now we are subsidizing this business at 120 percent of rent, and then we are saying to them, we are going to renew your loan, there is a forgiveness there. Then you are going to recognize that as a profit margin, and you are asking that we extend this out over 10 years. If we do this just for this one segment of the business community, and we do not do it for the other segments of the business community, haven't we sort of singled out an area of business we are already subsidizing for additional tax advantage. Where do we stop?

Secretary CUOMO. Senator, it is an interesting point.

Actually, I think the Administration's bill addresses your concern and I leave it to other Members to discuss whether or not S. 513 does that. Under the Administration's bill, we make your exact point. We say if you are going to get tax forgiveness, you should give us something back. Why should these owners get a write-down of income essentially without consideration the other way?

So under our proposal, we say, yes, we will give you that tax treatment because we understand that without the tax treatment, the transaction is almost impossible. You cannot have the owners come up at the time of closing with that piece of cash to pay the taxes, so we will allow you to stretch it out. But in return for the tax treatment, you the owner have to make sure 40 percent of the units in that building remain affordable for the long-term pursuant to the Low-Income Housing Tax Credit.

So there is a bargain and sale for that tax treatment. It is not a gift from Government. We give the owner the tax treatment, the owner gives back an assurance of affordability on 40 percent of the units. There is a new bargain and sale going forward, which is in the Administration's bill. It is one of the reasons we did want the tax legislation, together with the piece of authorizing legislation we are discussing here.

Senator ALLARD. I would like to move on to a little different subject area but I think we need to discuss this issue a little bit.

There has been much talk about the potential for default and the resulting FHA taxpayer bailout that would have to occur, but I think there is another issue. For example, the Government recently sold the loans on a number of projects to G.E. Capital. The Government recovered its costs and the projects are much more viable. In some cases, the Government simply mismanaged things and I have

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been informed that on one of the loans that G.E. purchased, the private landlords had made no payments on the loan since 1972.

In your opinion, what kind of real reforms are being taken in this bill in order to solve problems we are incurring with renewal of Section 8 contracts? That is the first question. Then second, are we really making strides to create a more efficient housing program, or are we just postponing the day we have to deal with projects that are not viable?

Secretary CUOMO. Senator, both good points. Two responses if I might.

Number one, we would only renew contracts with owners who we wanted to renew contracts with who were in good standing, they are projects that are operating well, they are taking care of the tenants, they are at reasonable cost, so we would not be renewing contracts which are bad relationships.

In some ways, this is an opportunity. We were locked into contracts for 20 years. The contract is expiring. Fine. If it is not a good relationship and it is not a good building, do not continue it. We have that opportunity for the first time ever. So we would only renew projects that work.

Number two, and your point is more profound than frankly just the mark-to-market discussion. The multifamily portfolio on the Section 8 side is problematic throughout. Of about a 30,000 project portfolio, we estimate about 5,000 are troubled properties. And the Department actually has a much broader effort than what we are discussing just today. It is what I mentioned in my opening comments, about the waste, fraud, and abuse that is the multifamily portfolio.

We are working with the Department of Justice, Attorney General Reno in what we call a "get tough campaign." We have done more debarments in the first 6 months of this year than we did the entire year last year. And it is a much different signal that we are sending to the Section 8 landlords. The days where you could get away without making payments are over. The days where you get a check and you leave tenants in squalor are over. The Department has a much different posture than that, and I think we are starting to see the results.

Senator ALLARD. Mr. Chairman, I see where my time is expiring.

Senator MACK. Paul, did you have a statement that you wanted to make?

OPENING COMMENTS OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman.

There are about 15 people standing out in the hall wanting to get in. I see a few vacant seats in the hearing room, and if people could tighten up a bit, maybe we could get some more people into the room.

Secretary CUOMO. They can have my seat, Senator.

[Laughter.]

Senator SARBANES. I am afraid it does not work that way.

Senator MACK. It might be interesting to have them up here in these seats. It is nice of you to offer though.

Secretary CUOMO. Thank you.

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Senator SARBANES. First, I just want to make a short statement. I was not able to be here at the outset, and Mr. Chairman I want to express my appreciation to you for calling this hearing. Senator Kerry, who is the Ranking Member with you on this Subcommittee, is at the Commerce Committee marking-up the Reconciliation package, which is, of course, what we will be doing here tomorrow morning. But he is very supportive of the work that you have done in addressing these issues, as am I.

I appreciate that the Secretary and his two Assistant Secretaries are here with us this morning. And I know Governor Thompson has come a long way to be with us.

At the confirmation hearing, and again today, the Secretary has made clear that addressing the Section 8 renewal problem is a number one priority. I think we all recognize that. And the central part of that problem is what to do with the assisted-housing portfolio that is receiving subsidies at well above market rates.

They are not feasible in an increasingly tight budgetary environment. Today those contracts cost us about $1.2 billion. But if we do not address this problem promptly, it is estimated that the cost would rise, as I understand it, to $7.5 billion by the year 2006.

The Secretary's been trying to find a solution to this problem. The specific HUD proposal and S. 513 differ in the means but I think there is a unanimity in terms of the goals; namely, to preserve affordable housing, weed out bad owners, and return this housing stock to a solid financial footing.

I think this hearing and tomorrow's markup can be viewed and ought to be viewed as a sign of the ability of the Department and this Subcommittee to work together to try to realize our common ends. Senator Mack has invested a great deal of time and effort over the past couple of years to come to grips with this crisis and I want to particularly acknowledge that this morning. This bill is the result of that effort.

A wide range of stakeholders have had an input into this legislation. Residents, owners, State and local government officials, nonprofit housing developers, housing managers, lenders, the Department itself, Members of this Subcommittee, and Senator Mack has brought them all together in an effort to craft this legislation.

Now, this is one step in the legislative process and we can continue to try to deal with this matter as a stand-alone bill. But I, for one, think that we need to address it in the reconciliation context. In a sense, we have almost been invited to do so. And I think not doing so would probably not advance the process.

Just as I was arriving earlier, you indicated—well, let me see if I understand. I take it that it is your view that while there are aspects of this legislation you would like to see adjusted or altered as we move through the legislative process, it is your view that we at least ought to get that process moving forward. Is that a fair understanding of your position?

Secretary CUOMO. Exactly, Senator. This is the priority for the Department and we have said that consistently, as you point out, from the confirmation testimony on forward, legislative package, management plan. This is the crisis, the crisis around the multifamily portfolio Section 8 and the renewals. And we think that rec-

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onciliation is a unique opportunity to move the process along, and we are very much in favor of that.

Chairman D'Amato pointed out that there would be an opportunity to make some adjustment and wanted to hear the recommendations so we could have some conversations over the next few days, and we found that very heartening, that receptivity to work in a bipartisan way. On that basis, we say let's move ahead.

Senator SARBANES. While I am pleased to hear that, I do want to say that I think Chairman Mack has always been open and receptive to suggestions and I do not see him as rigid in the sense of not being willing to entertain other approaches, and we all have an open mind.

This is a hard package to put together, obviously, and a great deal of work has gone into doing it. But if we do not move it now, I do not know that it is going to get moved later. In fact, I rather have my doubts about that. Therefore, this is probably the opportune moment and, in fact, the track that Chairman Mack is on carries with it the prospect of being able to resolve this issue in the fairly near future, which I think would be to everyone's advantage.

Mr. Chairman, I do not have any questions.

Senator MACK. If the Secretary would be willing to wait just one moment.

[Pause.]

We have one Senator who I think has some questions he would like to raise so if you would bear with us a moment.

Secretary CUOMO. It would be our pleasure.

Senator MACK. The one area that I did not engage in, of the three points that were raised, had to do with the State financing agency. Again, I am of the opinion that the way we have written this legislation does not require the exclusivity that you have implied or stated in your testimony this morning.

It is clear that our first, our major interest was to use State housing finance agencies. We believe that is an effective way to go. But by no means, have we created a situation that puts HUD in a position where the only entity that you can deal with is the State housing finance agency. And so while I understand your concern, I think that as we discuss this and work through this legislation, I would be hopeful that we could come to some agreement. We think that is an effective way to deal with this restructuring issue.

Secretary CUOMO. Mr. Chairman, that is heartening. Maybe it is an interpretation as opposed to a substance issue. And we agree that HFA's can provide an effective vehicle, not in all cases and in all places, obviously, but where they work, let's use them. Where they do not work, then let's find other vehicles. By the way, in some places HUD could do it directly. We do not have to hire anyone and pay any additional fees. We do have a workforce of 10,000 people. So in some cases HUD can do it, in some cases FHA can do it, in some cases we can use attorneys or accounting firms. We just want the flexibility to be able to use those options.

Senator MACK. I understand the importance of flexibility, but I think it is fair to say that the Subcommittee has concerns about HUD's capability of doing that. Not from the standpoint of desire or true interest, but we honestly believe that given the downsizing of the Department over the years, and all of the various issues that

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you are faced with, we have concerns, and that is why we have placed the emphasis on the State housing finance agencies.

So again, we will work with you on this, but I think it is fair to point out that concern.

Secretary CUOMO. And, Mr. Chairman, I agree with that concern and I would also be the first to say HUD cannot do it in all cases. But the inverse is not true, I do not believe, nor is it true that HUD cannot do it anywhere, and HFA's can do it everywhere.

Senator MACK. I did not say either one of those.

Secretary CUOMO. OK. Some places we have the capacity to do it. In some places, we have more capacity than the HFA's.

The current legislation says if you are qualified for Risk Sharing, which is a different program, 33 HFA's qualified, then you are qualified here.

Also, I would recommend that the Subcommittee read the Inspector General's comments on the use of HFA's which I believe are sobering if not prophetic. I hope, Mr. Chairman, that it is a question of interpretation and not substance.

Senator SARBANES. It seems to me that HUD could use the HFA's which, by definition, have a public interest mission, and shift, in effect, the burden. If they fail to carry it, it is their responsibility. They have had a public interest-oriented institution that did not meet its responsibilities.

I do not see it as sort of a challenge to HUD, I see it as an opportunity for HUD to devolve responsibilities in a way that could lead to them being dealt with more expeditiously. As you pointed out, what was there, 5,000 properties?

Secretary CUOMO. Five thousand properties.

Senator if I might, it is devolution without responsibility. HUD still pays the check, HUD has the liability. The HFA is only the agent to process the transaction. But the Federal Government is still on the hook for the initial payment as well as the long-term consequences of the transaction. It is not really devolution because they do not bear any responsibility. They are only an executing agent.

Senator SARBANES. Would the same be true of the private sector organizations?

Secretary CUOMO. Yes.

Senator SARBANES. Why would that make it any better?

Secretary CUOMO. It would not. In some places, that is why I would leave the flexibility. Some places where HUD does have the capacity, we have 81 field offices and some places we have an expert staff, very sophisticated, highly capable, use it there, some places an HFA, some places law firms just as agents, accounting firms as agents, just keep that menu open. That is the thrust of our legislation.

Senator MACK. Again, I do not think that we have any fundamental disagreement. I think it probably is an issue of focus, but we can discuss that during the time that we have to deal with this issue over the next weeks.

Secretary CUOMO. Great.

Senator MACK. I thank you for coming this morning. And again I appreciate your support of our effort.

Secretary CUOMO. Thank you, Mr. Chairman.

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Let us again commend you personally and the Subcommittee for all the good work you have done on probably the toughest issue facing HUD. I know firsthand how complex this issue is to grapple with and how many pressures you have from so many sides, so I personally commend you, Mr. Chairman, on the good work you have done to get this bill to this point.

Senator MACK. Thank you very much.

Now, we will call on Governor Thompson. We appreciate your being here this morning, Governor, and also your patience, as well. We thank you for coming and look forward to your testimony.

OPENING STATEMENT OF TOMMY G. THOMPSON
GOVERNOR OF WISCONSIN
ON BEHALF OF THE NATIONAL GOVERNORS' ASSOCIATION

Governor THOMPSON. Thank you so very much, Mr. Chairman.

Let me just start out by thanking you and Senator Sarbanes for working so hard in a bipartisan way. It is refreshing on an issue as complex as public housing and Section 8 to have such bipartisan support.

Before the Secretary leaves, I would like to commend him working with you. It was somewhat interesting for me, as a Governor that always is looking for more flexibility and States' rights, to have a Secretary from the Federal Government asking for flexibility. It made me feel good, Mr. Chairman.

But I would like to thank you personally for this opportunity to express the views of the National Governors' Association, which I am representing here today on the issue of expiring Section 8 contracts.

I am going to briefly summarize my testimony because I know that you have another meeting to go to and you are very busy, and I thank you very much for giving me this opportunity to express the Governors' appreciation for your particular bill.

I want to personally commend you, Senator Mack, and you, Senator Sarbanes, for introducing the Multifamily Assisted Housing Reform and Affordability Act of 1997. S. 513 is an important step toward solving the looming crises, as all of us know, in the Section 8 project-based assistance program. The Nation's Governors are pleased that Congress and the Administration are working to find timely solutions that preserve the affordability, but more importantly the availability of low-income rental housing.

We look forward to significant State involvement in restructuring and monitoring Section 8 contracts. The Governors support most of the provisions included in S. 513. We certainly would like to see additional flexibility granted to the States. We are especially pleased that the Senate is addressing this issue so promptly. And we urge Congress to act quickly to ensure passage of legislation this year.

There is no doubt that restructuring project-based Section 8 contracts will be complex and time-consuming. And we agree that HUD cannot do it alone. So why would Governors and State governments want to be involved in restructuring these efforts? The most basic answer is that Governors share with the Federal Government, as Senator Sarbanes just said, a belief in the importance of providing decent, safe, and affordable housing for low-income families and individuals. This partnership is the basis of the

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HOME program, the Low-Income Housing Tax Credit, Mortgage Revenue Bond program, all of which are key to State efforts to promote affordable housing.

Failure to renew expiring contracts or to address the financial viability of projects experiencing rent decreases could diminish the Nation's affordable housing stock and could displace thousands of very low-income tenants. Make no mistake, this issue has a very human face.

In my State of Wisconsin, our Housing Finance Authority oversees a Section 8 portfolio of over 17,000 residents, and approximately 76 percent of those residents are elderly and rely on Social Security as their only source of income. In fact, their income average is only $8,200 per year. Project-based Section 8 is the only program standing between these poor, elderly tenants and the streets. Clearly, Governors and States would face substantial problems if the contracts are not restructured correctly and quickly.

Due to the downsizing, as you have indicated, Senator Mack, and to limited capacity, the Department of Housing and Urban Development will not be able to renegotiate and restructure all of the thousands of Section 8 contracts expiring in the next several years. The restructuring process represents an extraordinary burden, and it would be difficult for HUD to address all expiring contracts while running all of its other programs.

Congress recognized that HUD needed help and that States are, and I want to emphasize that States are the logical partners to provide this help, when it set up the 1997 Portfolio of Re-engineering Demonstration program. At the 1997 winter meeting of all of the Governors, we adopted policy expressing the States' interest in playing a major role in the demonstration programs.

It is because Governors and the Federal Government do share a commitment to provide affordable housing that States are in such a strong position to help HUD restructure contracts. State agencies possess the experience as well as the expertise needed to perform the complex tasks of restructuring. Moreover, State agencies know local housing and finance markets and are well-qualified to make the judgment calls that will be necessary as each individual contract is renegotiated. State agencies also have the necessary skills to monitor long-term compliance with newly negotiated contracts. The Governors appreciate the primary role that you have given to States by S. 513.

S. 513 is also important because it is essential that existing financial obligations of the Federal Government to State-financed housing projects be honored. Federally-mandated changes in reimbursement to owners would jeopardize States' ability to meet their financing obligations under outstanding bonds. Federal changes could have serious consequences for all future financing capacity by eroding credit ratings and increasing the cost of borrowing. S. 513 protects these projects, and the Governors urge that these provisions be maintained.

The Governors also appreciate the proposed bill's commitment to share with the States money saved in restructuring. Many of the Reinventing Government programs that I have implemented in Wisconsin are based on this type of incentive. They do work and I thank you for them. Shared savings provide ownership, authority,

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and responsibility that help us to increase the chances of success. In order to be successful in restructuring contracts, States need as many tools as possible and time to process all contracts.

In Pennsylvania and Ohio, Governors Voinovich and Ridge especially could have faced serious problems if HUD does not allow for adequate time.

S. 513 authorizes a wide variety of restructuring tools that States or other entities can use in performing restructurings, including full or partial payment of mortgage debt, refinancing of debt, and the provision of Federal Housing Administration Insurance. The Governors support maintaining these provisions.

Another key aspect of flexibility, of course, is the authority to set rent levels. We do not know if the 120 percent is going to be adequate in all cases but you do allow for some waiver provisions. We ask you to streamline it so it can be used very successfully.

We also appreciate the additional flexibility that is needed in the rehabilitation. We are not sure that the $5,000 per-unit cap is adequate in all cases. We would ask you to be able to use it in a project basis so that we can use the total amount. State efforts would be enhanced if the cap to rehabilitation costs were somewhat structured to allow for more flexibility.

But however, in closing, I would like to emphasize once again the tremendous support Governors have for S. 513. We look forward to working with the Subcommittee to be able to increase the flexibility provided to States in this renegotiating work, and to be able to be more successful in this particular project. We thank you for that flexibility and that ability to renegotiate these contracts.

The Governors have a strong interest in having States perform contract restructurings at the States' level, and we believe we are uniquely qualified to partner with the Federal Government in this effort. We appreciate the primary role that you have given to us as States. We also appreciate the fact that this Subcommittee is addressing the Section 8 crisis so promptly. The risks are too great for all of us if Congress does not pass legislation this year.

Again, I thank you, Senator Mack, Senator Sarbanes, and the other Members of this Subcommittee for this particular very valuable piece of reconciliation legislation.

We hope that you advance it quickly and it gets passed this year.

Thank you very much.

Senator MACK. Thank you very much for your testimony and for your supportive comments.

Again, there is no question that the bill is written in a way that our preference is to use State agencies.

Governor THOMPSON. We like that, Senator.

Senator MACK. I understand that. But one of our greatest concerns is ensuring that whatever entity performs the portfolio restructuring for the Federal Government, that the entity acts in the best interests of the Federal Government.

I wonder if you might indicate why you believe State agencies may be the best choice to act as the Federal Government's primary partner in this restructuring? And do you believe that State housing finance agencies could effectively protect the Federal Government's financial and social policy interests?

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Governor THOMPSON. We are in the business. Absolutely. We are the closest to the people. The complaints from the tenants are going to come to us. We want to be able to maximize the flexibility but we also want to maximize the efficiencies and be accountable to you. We know that, as Governors.

I keep coming back on many different issues, asking for the opportunity for more authority, more flexibility. And I have always told you, give us a chance, hold us accountable. We will meet those standards and we will do it in a way that you are going to be appreciative and feel very good about it. I can only speak now for Wisconsin, but we believe that our Public Housing Association has done an excellent job. We have expanded our public housing stock, and I think we have been recognized as one of the leaders in this area and we continue to do more and we could do more if we had more flexibility.

Senator MACK. Appreciate it.

Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

Governor, thank you very much for a very thoughtful statement. I appreciate it.

The Secretary made reference to HUD's Inspector General's—I have not read that report but I take it that it is a critical view of some of the State agencies, and I wondered if the National Governors' Association could undertake to review the Inspector General's report, if they have not yet done so, and let us have your analysis of the report, and hopefully not simply rejecting it all out of hand. And if there are things in there where they are making some valid points, how the Governors' think those might be addressed by the State agencies. I think that would be helpful.

Governor THOMPSON. We would appreciate that opportunity, Senator Sarbanes. We have two individual staff members from the Governors' Association here today, Sue and Tim, and they will take your request and have a response to you within the week. In fact if you need it by tomorrow, we will do that as well. We will stay up tonight and get it done.

That is how quickly States can act, Senator Sarbanes.

[Laughter.]

So if you need it tomorrow, you will have it tomorrow.

Senator MACK. I did notice your assistants seated behind you kind of wondering how quickly they were going to be able to——

Governor THOMPSON. Can you have it done tomorrow?

Senator SARBANES. We would rather that it have depth and breadth to it, so if they need a little more time, they should take that time. Thank you, Governor.

Governor THOMPSON. Well, we want to be very responsive, just as we want to make sure that we are held accountable and we know we can do the job, Senator.

Senator MACK. Senator Faircloth.

Senator FAIRCLOTH. Thank you very much, Governor Thompson, for being here.

Governor THOMPSON. It is always a pleasure to see you, Senator Faircloth.

Senator FAIRCLOTH. You say that is how fast States' act. That is how fast some States can act, such as Wisconsin.

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Governor THOMPSON. Thank you.

Senator FAIRCLOTH. Just as a brief personal note, the welfare bill that we have in place is there largely because of the support of Governor Thompson and a few other conservative Governors. Governor Thompson is my favorite Governor. He is a little liberal on welfare programs, but——

Governor THOMPSON. I am trying, Senator Faircloth.

[Laughter.]

Senator FAIRCLOTH. Governor, in this bill, we are transferring the oversight of the restructuring program to the State and local housing agencies. Number one, do you think it is a good idea?

Governor THOMPSON. Absolutely.

Senator FAIRCLOTH. Wisconsin, and you think other States too are capable of handling this?

Governor THOMPSON. Absolutely. The Governors at their February meeting, their winter meeting, unanimously on a bipartisan basis passed a resolution asking for this kind of flexibility. And I am confident that we will be able to assume that accountability and be able to handle it, we will be able to renegotiate these thousands and thousands of contracts and do it in a way that you are going to say, that is the way it should have been done.

Senator FAIRCLOTH. Let me ask you. Do you believe or should States and local agencies need an incentive to take on the task?

Governor THOMPSON. I do not think so, I really do not. I think we want to do it. When I show you, Senator Faircloth, that Governors need more flexibility, if you give us the flexibility, we can handle it. I have also been one of those few Governors that believe we can do it with less money, if you just give us the flexibility.

Senator FAIRCLOTH. Well, not only do you believe it, you have demonstrated it clearly through the programs you have run, that any time you could get the Federal Government out of a program, you have demonstrated you could run it in Wisconsin better than the Federal Government you are running it for.

Governor THOMPSON. Thank you. We try.

Senator FAIRCLOTH. I have just one, it's really not a question but as I sat here this morning and the overall concept of a program in which you lend a person the money to build a housing project, and of course in reality we all know that they actually borrowed more than it cost to build the project so they had a net windfall before they ever moved a tenant in. Then pay 120 percent of the going rent in the neighborhood.

Governor THOMPSON. It is a good deal.

Senator FAIRCLOTH. Absolutely. Then they have no liability if they want to throw it up. In other words, there is no contingency going back to them on other real estate or anything, just give you that one.

Governor THOMPSON. You and I should have been in that business, Senator.

Senator FAIRCLOTH. Then on top of that, we did not even collect the rent. We paid them the rent on the tenants and some of them went 10 and 15 years and never paid the rent to the Government.

Governor THOMPSON. That is why we are here and I think that is why it has to be restructured, Senator, and that is why I think the States' involvement is going to be helpful.

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Senator FAIRCLOTH. I am sorry Secretary Cuomo had to leave and I do not mean to—but he said how tight money is now, that we could not afford to go on as we had been. Tight money or loose money, that was a stupid deal for the Federal Government ever to have been in, and the reason we have a $5.4 trillion debt today is because of some of the foolishness that has gone on in the past.

I thank you for being with us.

Governor THOMPSON. I thank you, Senator.

Senator MACK. Governor, again, thank you for coming. We appreciate your testimony and look forward to working with you.

The third panel, if you will come forward. Mr. James Logue, Mr. John Koelemij, Mr. Albert Walsh, Mr. James Grow, Ms. Mary Yeaton, and Mr. Shekar Narasimhan.

Several of you have been here before and I welcome you back.

Senator D'Amato asked if I would put in the record a letter from the New York Housing Conference in support of the legislation, which I will do.

Mr. Walsh, Senator D'Amato also asked me if I would make a special comment with respect to your being here. He would like to offer his special thanks to you for your significant contribution to the legislation before us, and indicated that you had a long and historic record of public service to the affordable housing community in New York.

Senator D'Amato would have said that himself if he was here, but as you know, there is a markup taking place on other legislation in the Senate, and so he could not be with us.

Again, I welcome you and thank all of you for your participation this morning. With that, I will turn to Mr. Logue first.

Mr. WALSH. Senator, before that, let me thank you personally, and if you would convey my thanks to Senator D'Amato for those very gracious remarks.

Thank you.

Senator MACK. I certainly will.

Mr. Logue.

OPENING STATEMENT OF JAMES LOGUE, III, PRESIDENT NATIONAL COUNCIL OF STATE HOUSING AGENCIES ON BEHALF OF THE NATION'S STATE HOUSING FINANCE AGENCIES

Mr. LOGUE. Thank you, Mr. Chairman, and Members of the Subcommittee.

I am Jim Logue, President of the National Council of State Housing Agencies which represents State Housing Finance Agencies (HFA's) in all 50 States. I am also Executive Director, under Governor Engler, of the Michigan State Housing Development Authority. I also previously served at HUD as Deputy Assistant Secretary for Multifamily Housing under President Bush.

Mr. Chairman, NCSHA commends you and your colleagues for introducing the first and best legislation to address the Section 8 contract renewal crisis.

We thank you for involving the State HFA's in the development of this legislation. Thanks to your extraordinary efforts to reach out to the entire affordable housing community, this bill is a consensus product.

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We also share your sense of urgency to move this legislation as quickly as possible this year. The time is now for Congress to act. Your bill would achieve Federal budgetary savings. You recognize, however, that this is not just a budget exercise. Your bill also would put this housing on sound financial footing, preserve it as affordable, protect its residents, and stabilize neighborhoods. Your approach is the right approach.

Mr. Chairman, I am here to tell you today why HFA's are the most appropriate entities to handle the Section 8 restructuring task. As you recognize, HUD lacks the staff, resources, and capacity necessary to effectively handle Section 8 restructuring. Even HUD admits it cannot do this work on its own.

Unfortunately, HUD's legislation fails to draw adequately upon the expertise and public purpose mission of HFA's. Unlike your bill, HUD would not give State HFA's priority for handling restructuring. Instead, HUD's proposal would rely heavily on the private sector. The use of private entities poses a dangerous risk to the preservation of the housing stock as affordable and the protection of low-income residents. It is no secret that private firms are motivated by profit, not public purpose like HFA's. We are deeply concerned about HUD's proposal and ask you to reject it decisively.

Mr. Chairman, we urge you to insist on the priority your bill establishes for qualified HFA's to handle the Section 8 restructuring process. HFA's are uniquely able to take on this challenge for two primary reasons.

First, our mission. HFA's are permanent, public institutions chartered by State governments expressly for the purpose of creating and preserving decent, safe, and affordable housing. HFA's operate as self-sustaining, efficient businesses, reinvesting our revenues in affordable housing programs. For that reason, we seek reasonable compensation for property restructuring. Make no mistake, however, about our motivation. HFA's have no expectation that restructuring will be a profit-making venture. In fact, the uncertainties involved pose a real risk that HFA's may not even be able to cover our costs.

Unlike private sector entities, HFA's are publicly accountable. Established by State law, HFA's are subject to oversight and audit by State government.

Second, HFA's have the specialized expertise necessary to restructure the Section 8 portfolio effectively. Most State HFA's have over 25 years of experience in housing finance, development, rehabilitation, and asset management. HFA underwriting expertise includes the full range of technical resources necessary to analyze, restructure, and reposition affordable housing developments.

HFA's have an outstanding track record in loan servicing and asset management. HFA-financed properties have exceptionally low incidences of default and foreclosure as recognized in our consistently high bond ratings.

HFA's are experienced in working in partnership with the Federal Government to administer Federal programs, such as the Governor mentioned, including the Low-Income Housing Tax Credit and the HOME program.

HFA's are familiar with third parties in our States which would carry out contract services, such as appraisals and physical needs

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assessments with strict HFA oversight. In contrast, HUD contracts with large, national contractors have produced often weak results.

HFA's have longstanding systems in place for identifying negligent owners and managers, enforcing compliance standards and imposing sanctions, including removing inadequate owners and managers when necessary. HFA's have no tolerance for corrupt or inept managers and owners.

Mr. Chairman, Congress recognized HUD's limits and the State HFA's abilities when it wrote the Section 8 Restructuring Demonstration last year. Thirty State HFA's with three-quarters of the eligible properties have been approved by HUD to serve as restructuring designees. Michigan is one of them.

We have been eager to get started for many months. Nonetheless, HUD has been extremely slow to get the program up and running, taking nearly 7 months to provide HFA's with fundamental guidance on our role. Frankly, we have begun to suspect that HUD is deliberately resisting HFA's in restructuring, and that is supported by the Secretary's testimony here this morning. Recent actions and statements certainly confirm that.

Secretary Cuomo today questioned publicly the advantages of working with HFA's, suggesting that HFA's will only add an additional layer of bureaucracy into the restructuring process. HUD officials have also said that HFA's are interested only in restructuring fees. Despite all of this, HFA's are eager to proceed. Three States have already submitted management plans to HUD. This month, HUD approved the plans presented by Ohio, which has the largest portfolio of eligible properties, and Massachusetts.

Mr. Chairman, HUD officials assert that your bill will not adequately encourage HFA's to act in the Federal Government's best interest because HFA's have nothing to risk. HFA's, I maintain, share the Federal Government's interest in maximizing efficiency and savings to the Government. Furthermore, HFA's are taking significant risk by offering to assist the Federal Government in this effort. These risks arise from the uncertainties associated with working with HUD, the real possibility that HUD's compensation will not cover HFA's costs, and the danger that HFA's will forego greater opportunities by investing our staff and resources in the restructuring process.

I can only commit to you, Senator Mack, and Members of the Subcommittee, that the State HFA's are ready, willing, and able to do the job. I take exception to the comments that were made this morning by Secretary Cuomo on the questions related to the HUD's Inspector General. We are not aware of any serious concerns raised by the HUD IG. They certainly have not been brought to our attention. And I would suggest that we are the appropriate mechanism, as envisioned by your bill, for this restructuring job.

Senator MACK. I appreciate your comments and I might suggest that you do take a look at the Inspector General's comments and give us some response to it. I think that would be helpful.

Mr. Koelemij, again, welcome, and you have been involved in these issues for as long as I can remember in the State of Florida. You have a tremendous reputation, and I am delighted that you are here with us this morning.

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OPENING STATEMENT OF JOHN J. KOELEMIJ
PAST PRESIDENT
NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. KOELEMIJ. Thank you very much, Senator. It is a pleasure to be here.

Mr. Chairman and Members of the Subcommittee, my name is John Koelemij and I am a home builder from Tallahassee, Florida and Past President of the 190,000 member firms of the National Association of Home Builders.

On behalf of the NAHB, I thank you, Mr. Chairman, for your leadership and perseverance in continuing to achieve both a responsible as well as equitable solution to the task before you with respect to the expiring project-based Section 8 rental assistance contracts. I also want to publicly thank and acknowledge our appreciation for the Subcommittee's professional staff, their accessibility, and their in-depth knowledge of housing programs. They serve you well.

Further, I thank you for the opportunity to comment on S. 513, the "Multifamily Assisted Housing Reform and Affordability Act of 1997." If the Section 8 rental assistance contracts are not renewed, these projects are at serious risk of default and foreclosure.

Most owners of this valuable housing stock are dedicated to providing good housing. Residents depend on this rental housing for shelter and security. In many neighborhoods, this housing serves as an anchor for the community. These are very sound reasons, indeed, Mr. Chairman, for taking actions that will preserve this housing in the affordable housing stock, minimize the risk of loss and likelihood of increased liabilities for responsible owners, minimize the displacement and uncertainty for current residents, and protect the physical assets that this housing provides.

NAHB believes that the Section 8 portfolio re-engineering should contain certain elements essential to providing a responsible and equitable solution.

First, the formula should be clear, workable, and flexible, as a "one size fits all" system simply will not work. S. 513 calls for revised rents based on comparable unassisted properties in the area or 90 percent of HUD's Fair Market Rent if no such measure is available.

Second, if the debt is to be restructured, the restructuring entity should be a public body. Only public bodies have the accountability necessary for balancing social policy with sound fiscal policy in a responsible manner, while maintaining accountability to taxpayers.

Third, the rental assistance should remain as project-based. Project-based assistance will provide a combination of adequate protection for the current residents, the fiscal viability of responsibly-owned and well-managed housing, overall reduced cost to taxpayers, and affordable housing for the community.

The fourth element is maintenance of FHA insurance. Without FHA insurance, many otherwise good housing projects will be unable to obtain long-term financing.

Fifth, Mr. Chairman, responsible owners of this housing should be provided adequate protection from the likelihood of unnecessary tax consequences as a result of debt restructuring. If the Federal Government takes action to restructure the debt, it has the respon-

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sibility to protect those stakeholders who would otherwise be penalized, albeit unintentionally, as the result of these actions.

Finally, restructuring should not abrogate an owner's right to prepay the existing mortgage.

Mr. Chairman, I am very pleased to say that Senate Bill 513 embraces all these important elements.

When I appeared before this Subcommittee a year ago, I offered our support for last year's version of S. 513. This year, I again offer our support for your bill. It embraces not only the basic principles for responsible housing policy, but also a clear, concise, and workable formula that protects all stakeholders in the program.

We remain concerned, however, with the following issue:

NAHB believes that the bill should contain a more flexible "exception rent" provision. NAHB is aware of some projects, particularly in New York City, as well as rural areas, where comparable properties do not exist, and where operating costs are high in comparison to HUD's Fair Market Rents.

S. 513 places a hard cap on exception rents at 120 percent of the HUD Fair Market Rent and limits the use of exception rents to 20 percent of the units expiring in any one year. However, a HUD commissioned study indicates that market rents would not cover operating expenses in 1,100 of the 8,400 projects in the privately-owned, FHA-insured, HUD-assisted portfolio. Many of these worthwhile projects, particularly elevator structures for seniors in rural areas, would have to be removed from the affordable housing stock.

NAHB urges that these limitations be removed and a more flexible system be established for exception rents.

Mr. Chairman, thank you for the opportunity to present our views. I will be happy to respond to any questions you or the Members may have.

Thank you.

Senator MACK. Thank you, very much.

Mr. Walsh.

OPENING STATEMENT OF ALBERT A. WALSH, ESQ. BOARD MEMBER, NEW YORK HOUSING CONFERENCE

Mr. WALSH. Mr. Chairman, I want to thank you again for the opportunity of appearing before this Subcommittee this morning to express the views of the New York Housing Conference on this most important piece of legislation.

The New York Housing Conference was founded in 1973 and became affiliated with the National Housing Conference in 1975. It is composed of the representatives of for-profit and nonprofit developers, owners and managers of low- and moderate-income housing, financial institutions, housing professionals, community leaders, and affordable housing advocates.

As Senator D'Amato indicated in his very gracious remarks earlier, I have been involved in Government-assisted housing both as a public official on a State and local level and as a practicing lawyer for more than 30 years.

As we heard earlier this morning, many thousands of affordable housing developments throughout the country, including more than 600 in New York City, were financed by HUD some 18–20 years ago, by using a combination of FHA insurance and project-based

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Section 8 subsidies. For the most part, at least to my personal knowledge in New York City, these developments were modestly designed, have been well-maintained through the years, and represent an irreplaceable housing resource for low-income families.

However, as we also heard earlier, the Section 8 program contains some significant flaws. First, the Section 8 contracts were not co-terminus with project mortgage, thus placing the FHA Insurance Fund, the economic viability of the developments, and the homes of hundreds of thousands of tenants at risk at the end of the contract term; which is happening now.

In addition, in many cases the cumulative effect of so-called automatic Annual Adjustment Factors, applied over the years, caused the developments to have subsidized rents far above the amounts needed for debt service, operating expenses, required reserves, and reasonable rates of return, thus costing the Federal Government more subsidy than necessary to maintain the developments as decent affordable rental housing.

You and your colleagues are to be commended, Mr. Chairman, for the solutions now embodied in S. 513. Given the agreement of Congress and the Administration to balance the Federal budget by the year 2002, the staggering dimensions of the projected Section 8 contract renewal costs, and the potentially devastating effects of nonrenewal on residents and communities, this bill constitutes an absolutely essential first step in resolving Section 8 HUD funding crisis.

I was glad to hear from Secretary Cuomo that all parties are agreed on the critical nature of that issue.

The bill provides a comprehensive structure and mechanisms through which the spiraling costs of Section 8 assistance can be abated and a majority of assisted developments preserved within the parameters of the bipartisan budget agreement.

The essence and, if you will, the genius of S. 513 is the simultaneous restructuring of the FHA-insured mortgage and the Section 8 contract at the time of renewal, which you and other speakers this morning have so well described that I do not need to and will not take the time to repeat.

However, coming from New York City, where both the development and operating costs of housing are high, and the HUD FMR's are low or relatively low, because they are based in large part on recent moves into rent-regulated housing, which is below market by definition, we are particularly appreciative of the provisions of the bill, just recently referred to, allowing the Participating Administrative Entity to set the budget-based exception rents up to 120 percent of the HUD Fair Market Rent for up to 20 percent of the units in its geographic jurisdiction; and the further provision allowing HUD to increase that 20 percent geographic limitation upon a finding of special need.

I beg to disagree with Secretary Cuomo in this regard. The New York Housing Conference is certainly fully in favor of mixed-income housing, and I personally am in favor of mixed-income housing. But not at the risk of "vouchering out" the Section 8 contracts needed to support debt service on the reduced mortgage, reasonable operating expenses, and required reserves. If those costs cannot be supported by the vouchered tenants, then you have to have project-

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based Section 8 assistance continue. I would also beg to disagree with the Secretary where he indicates that 90 or 100 percent of FMR's should be enough; that the exception rents in your bill are too high, there is no need to go to 120 percent.

The fact is, as has been indicated here by other witnesses, where land costs, construction costs and operating expenses require it, if you do not have that provision for exception rents, good projects and good owners will be forced into default, the projects will be lost, and the tenants will be homeless. That is not a result that anybody wants to see.

Instead of mandating in a bill some arbitrary mix between vouchers and project-based assistance, it has to be done in the kind of careful restructuring process that is set forth in S. 513.

The bill recognizes that the continued availability of FHA insurance, adjusted to market levels, and project-based Section 8 assistance, at levels sufficient to service the restructured debt and legitimate operating expenses, are essential to the continued existence of this absolutely irreplaceable supply of affordable housing. While the Section 8 contract must be renewed annually, the continued presence of FHA insurance makes it likely that such renewals will, in fact, occur.

The New York Housing Conference strongly supports the concept of State and local housing finance agencies as the primary restructuring entities.

I am, as I indicated earlier, a former New York State and City housing official, having served both as Director of the New York State Housing Finance Agency and as the first Chairman of the New York City Housing Development Corporation, and I agree with the statements previously made by Mr. Logue and Governor Thompson in regard to the ability and public accountability of such agencies.

Senator MACK. Mr. Walsh, if I could get you to wrap up, I would appreciate it.

Mr. WALSH. I would like to take a moment or two, Mr. Chairman, to comment on the tax issue, if I might, because again, I beg to differ with the Secretary.

First of all, I have been around a couple of years on these kinds of issues, including Federal legislative issues, and I believe that both the jurisdictional and scheduling problems of getting a bill enacted that amends the Internal Revenue Code, as well as making substantive reform of the housing programs, is going to be very difficult and may, in fact, not happen. Therefore, the Secretary's bill, including the so-called tax fix, may never become law.

Additionally, the kind of bifurcated mortgage; first mortgage, second mortgage that is in your bill, Mr. Chairman, has precedent in the tax law. It was done in the mid–1970's with the Federal 223(f) program ensuring the first mortgages of Mitchell–Lama projects in New York City, and the City taking a second mortgage. Those transactions did pass Internal Revenue Service muster.

Now, admittedly, that was 20 years ago, and the Tax Law has changed. It is not an identical parallel, but at least it is a very, very similar kind of thing.

Second, the Administration's bill talks about stretching out tax payments for 7 or 10 years, depending on whether it is an exten-

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sion or a sale. Rather, we believe that the bill should leave the taxpayer in the same position he would be in if he had never engaged in the restructuring. That would be fair. This is not. Also the Administration's bill imposes artificial and arbitrary limits on even its limited tax deferral. You do not get any tax relief for a mortgage write-down under 30 percent, and you do not get it if you have over a 75 percent write-down. The Secretary did not mention those things.

I did a quick check in New York by telephone over the last 4 or 5 days and found that a majority of the projects that might be eligible for restructuring in New York, in fact, will require 50 to 75 percent, and maybe more than 75 percent write-down. So they would not be eligible for any tax relief under the Secretary's bill.

The Secretary's bill also takes away what has been in the tax law for as long as I can remember, a step up in basis on death. So even dying will not help you defeat this tax on phantom income.

So I do not consider the Secretary's bill a good tax solution.

Thank you, Mr. Chairman. I'll be glad to answer any questions.

Senator MACK. I appreciate your comments.

Ms. Yeaton, again welcome, and we look forward to hearing your comments.

OPENING STATEMENT OF MARY YEATON
BOARD MEMBER, NATIONAL ALLIANCE OF HUD TENANTS

Ms. YEATON. Thank you.

My name is Mary Yeaton and I live at the Charlesbank Apartments in Boston, Massachusetts. I am a Board Member of the National Alliance of HUD Tenants which will be referred to as NAHT. On behalf of NAHT, I am pleased to submit these comments to the Subcommittee in support of S. 513.

NAHT appreciates the invitation to testify before Congress on legislation which affects our homes. Founded in 1992, NAHT is the only national membership organization representing the 2.1 million lower-income families served by HUD's multifamily portfolio. Our membership, including tenant groups and area wide tenant coalitions in 24 States, has led the grassroots fight against proposals to voucherize and deregulate HUD's multifamily housing and for alternatives such as S. 513 that would save our homes instead.

NAHT supports the Subcommittee's approach to Section 8 renewals and mortgage restructuring as outlined in S. 513. The bill represents a thoughtful, workable framework to preserve assisted housing in a manner largely consistent with NAHT's principles. In particular, the requirement in S. 513 for owners to renew project-based Section 8 insurance would preserve affordable housing and minimize the risk of tenant displacement. S. 513 also would allow HUD to delegate restructuring to State or local governments, but not to for-profit companies. This would help avoid a Resolution Trust Corporation-type "fire sale" of HUD housing and ensure that the public interest is protected. By contrast, HUD's approach and House Bill 1433 do not meet these tests.

Tenants' objections to voucherization are by now well-known and are summarized in our written testimony. NAHT believes that deregulation and voucherization can and should be separated from the plans to financially restructure HUD's project-based Section 8

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housing, an otherwise worthy goal. While a good start, S. 513 could be improved in several areas.

One issue deserves special mention today. Last week, Congress voted to reduce the required notice period to tenants of expiration of recently renewed Section 8 contracts from 1 year to 6 months. NAHT certainly agrees with the proponents of this change that HUD's current notice letter is poorly worded and is confusing to tenants. However, to respond by withholding information from the tenants about their true risk situation until it may be too late is a mistaken, if well-intentioned approach.

We urge the Subcommittee to restore the 1-year notice requirement or, at least, to clarify in Committee Report language that the new 6-month notice is a minimum requirement which HUD can exceed by regulation.

Perhaps the least developed concepts in S. 513 have to do with the role of tenants in enforcement of HUD's standards in properties with Section 8 contract renewals and/or restructured mortgages. HUD is currently woefully understaffed to carry out its oversight obligations. NAHT believes there is an alternative which can preserve and improve the assisted stock at virtually no cost to the Government. Let the tenants assist HUD in its oversight of HUD housing.

Tenants across the country, working with NAHT and its affiliates, have already initiated a revolutionary volunteer effort to serve as the "eyes and ears" of HUD. In New York and New Jersey, NAHT tenants have been meeting on a quarterly basis for over 3 years with HUD's multifamily housing staff to identify problems and work out solutions. These meetings have resulted in dramatic improvements in people's living conditions, HUD's enforcement response, and agency morale, at virtually no cost to other taxpayers.

Some people talk about "Reinventing Government," through NAHT, and with the cooperation of HUD, tenants are actually doing it—from the ground up. With S. 513, Congress has a unique opportunity to join this exciting effort. In brief, Congress could:

First, establish a tenant's right to repair and be reimbursed by HUD where HUD withholds Section 8 payment, as passed by the House in 1994.

Second, establish a right of Section 8 tenants to withhold rent and pay into an escrow fund for repairs.

Third, establish tenants and their organizations as third-party beneficiaries to HUD Section 8 and mortgage contracts with the power to sue for enforcement.

Fourth, allow tenant-based consortiums to participate as subcontractors to HUD and/or Participating Administrative Entities to assist in oversight of the assisted-housing stock.

Fifth, clarify that PAE's and qualified nonprofit contractors may assess HUD's sanctions on nonperforming owners and managers.

Sixth, allow tenants and tenant-based organizations to sue for enforcement under the Federal False Claims Act.

Seventh, provide for technical assistance funds for tenant organizations to participate fully in project restructuring and oversight. NAHT requests that the Subcommittee provide at least $20 million annually for tenant outreach and training to ensure that residents

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are able to participate as full partners with HUD and PAE's in the mortgage restructuring and project oversight process.

In conclusion, with S. 513, the Subcommittee has an historic opportunity to preserve housing, prevent displacement, save a long-term budget authority, and empower residents to help oversee our homes. In particular, by empowering these citizen volunteers to be partners with HUD in enforcement, Congress will augment the Department's limited staff to safeguard its investment in Section 8 housing. By enlisting residents as HUD's "eyes and ears," to arrest problems before they require more expensive solutions, Congress will save HUD money otherwise needed for more extensive repairs in the future. Accordingly, we urge that language accomplishing these objectives be added to the proposed Senate bill.

Thank you for the opportunity to make tenant voices heard in this process.

Senator MACK. Ms. Yeaton, thank you for your comments, and we certainly will consider the suggestions that you have made.

We did act on one of those already. I cannot say we can act on all the others as quickly, but I believe that we have solved the problem about the notice requirement in our bill, we have the 12-months notice requirement. So we have at least addressed one of your concerns here this morning.

Ms. YEATON. Thank you very much.

Senator MACK. Thank you.

Mr. Grow.

OPENING STATEMENT OF JAMES R. GROW
ATTORNEY, NATIONAL HOUSING LAW PROJECT

Mr. GROW. Good morning, Mr. Chairman, and Senator Reed. I am an attorney with the National Housing Law Project, a national nonprofit organization in Oakland, California.

My role in this issue has been to work with resident leaders, nonprofit and community organizations, and local governments around the country over the last few years, as restructuring policy has been debated. And it is from that experience that I would like to share a few views with you.

I would like to echo the commendation of your leadership and the staff's extraordinary efforts to produce this legislation. I have experienced a degree of openness from your staff that I think is truly exceptional.

I would like to step back for a second and talk, though, about the context. This is not just about saving money, it is about providing housing for very, very low-income families. This is a very sound housing stock. It serves predominantly people with very, very low incomes, about half of them are elderly people with disabilities. Their average income is somewhere around $8,000 per year.

Now a spectrum of families resides in this housing of all low incomes, but the average income is fairly low, to the point where these families cannot even afford to pay the operating expenses of their housing. They need Section 8 subsidies in order to afford a decent place to live.

At the same time, this society faces growing very low-income housing needs, as the incomes of our poor families cannot keep pace with rising housing costs.

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So the preservation of this Section 8 inventory is absolutely vital.

At the same time, it is an historic opportunity to make improvements in the delivery system, and that is what S. 513 commences. And for that, I would like to commend you and I would like to focus on four or five key elements.

First, the continuation of project-based assistance. Project-based assistance is very important in providing long-term stability to the housing and to the families. After restructuring, continuing the assistance as project-based will be more cost-effective than shifting to a tenant-based format. Also project-based assistance provides security of tenure for residents which tenant-based assistance does not.

I would like to take issue with HUD's position expressed here this morning that somehow if you continue the contracts as project-based, you cannot have income mix in these developments. That is just inaccurate. Section 8 can serve a wide range of incomes, often up to $20,000 in family income, and you still will need to draw on Section 8 subsidy. Those are hardworking families. We do not need to shift to vouchers in order to provide housing for their needs.

Second, the affordability restrictions in your bill are commendable. These are the way that the public ensures that restructuring is used for the public benefit. And here there is a key role played by the soft-second mortgage, which takes the unsupportable debt and moves it into a secondary status bearing interest at the cost of Federal funds.

That mortgage will be held by HUD, probably serviced by participating administrative agencies, but it will also be the vehicle through which the Government ensures that its affordable housing mission is carried out.

First, there will be a duty to accept project-based Section 8 as long as the Government makes it available. That is very, very important, much better than an arbitrary cutoff on the owner's duty to accept the subsidy. We are giving owners benefits in this program and the public has to ensure that its interest in providing housing for needy families is protected.

Second, the rents will be adjusted probably based on the cost increases after restructuring, and over time as market values increase, this will provide some affordability to this housing stock beyond the duty to accept Section 8.

The third key feature is tenant and community participation and the resources to do it. Your bill is very good in specifying events where tenant participation and community participation is required, both in the restructuring process and in the ongoing monitoring of the operation of the housing. It also provides modest resources to allow that to happen.

The next strong point is the bad owner screen—getting rid of bad owners who have not been performing and transferring those properties to responsible tenant and/or community-based owners. That will improve performance and will be a vital tool to ensure that when housing has not been kept up to standard that it is transferred to capable stewardship.

The last thing I would like to emphasize that is very positive is the recognition that rehabilitation needs of this inventory need to be analyzed and that resources need to be provided to take care of

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these problems, both contributions from the Federal Government and contributions from the owner who is restructuring.

I have some question about the adequacy of the $5,000 cap, which also may not work in certain higher cost jurisdictions. We would probably like a little more flexibility in the amount of the cap and how it is determined geographically.

Finally, I would like to close by saying that this is a very strong start. We need to bear in mind that it does not deal with providing incentives for the higher value properties, which are a whole other segment of the inventory. In order to preserve those properties who have a Section 8 contract rent that is actually less than their market value, we will need to adopt a separate proposal.

I think we could do a lot more in terms of transferring the stock to responsible tenant-endorsed community-based ownership in the future. The bill makes a good start by culling the bad owners, and by requiring the owners to put up some money for rehabilitation. But I think that in the long run, we are going to have to keep our focus on this issue of tax relief in order to provide an actual economic incentive, not just a regulatory program, to encourage owners who will be increasingly looking for ways to make money out of a stock that is not necessarily set up to deliver large returns.

We are going to have to provide ways for them to exit the stock and positive tax incentives are going to probably be the only way to do that, so long as they are coupled with an adequate public benefit.

Thank you, Mr. Chairman.

Senator MACK. Thank you very much for your comments, and we will get back to some questions here in a moment.

Mr. Narasimhan.

OPENING STATEMENT OF SHEKAR NARASIMHAN
PRESIDENT & CEO
WASHINGTON MORTGAGE FINANCIAL GROUP, LTD.
ON BEHALF OF THE
MORTGAGE BANKERS ASSOCIATION OF AMERICA

Mr. NARASIMHAN. Mr. Chairman and Senator Reed. I am Shekar Narasimhan, President and CEO of Washington Mortgage Financial Group. Our company originates and services loans for Fannie Mae, Freddie Mac, insurance companies, and private mortgage conduits, as well as loans insured by the Federal Housing Administration, FHA. We service over $7 billion in loans, of which $3.5 billion represent FHA-insured mortgages. Of the FHA-insured loans, 23 percent, or about $820 million, are secured by projects that are supported by some form of housing assistance payments, from 20 percent to 100 percent project-based.

Thank you for the opportunity on behalf of the Mortgage Bankers Association of America to offer our support and our comments. In the interest of time and having the benefit of being the last speaker, I am going to paraphrase my comments, and we will just enter the written testimony.

We applaud your efforts, Mr. Chairman, to restructure the financing and to reduce tenant rents for those FHA-insured multifamily projects with above-market rents that currently receive Section 8 subsidies.

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We appreciate the recent modification of Section 104(a)(2) of the bill that addresses the procedures by which the mortgage restructuring plans are to be written. What it recognizes, essentially—and your staff corrected some version that we had of the draft—is that the plans shall be developed by the owner, in cooperation with the servicing mortgagee, with a Participating Administrative Entity.

What we recognize and what we have been suggesting is that the servicing mortgagee is a stakeholder. We represent, if you will, the investor or the lender who actually owns either the mortgage instrument or a participation in that instrument, or a GNMA security which is backed by the mortgage.

What is necessary for this to work, with the magnitude of the task ahead of us, is to utilize the services of all the entities in this process, including those stakeholders that are in the private sector, but with strict time schedules and process.

This is a business of details. I recognize that legislation cannot possibly encompass all those details. But this is going to be a business that we will live with for the next 5 years, and we appreciate, again, your cooperation in ensuring that we have a role in this process.

Let me take a few moments to focus the Subcommittee's attention on several areas that we would like to just comment on, which we think could be adjusted and improved prior to completion.

One involves a process that, if left in the bill, we believe would cause a significant problem for the lending and the investing community. Two are suggestions for improvement, and the third is just a suggestion that perhaps this may be an opportunity, since after many years we seem to have the opportunity to get a housing bill in the Congress, to reform the FHA multifamily programs once and for all and put them on a permanent, self-sustaining footing.

Senator MACK. You're not suggesting that we add all that in this legislation, are you?

Mr. NARASIMHAN. Mr. Chairman, if it were possible to, we would suggest it.

I would like to comment on the one problem that we believe still remains in the bill. It is in Section 107(a)(1), and it is a latitude that is permitted to HUD or its designee to force a mortgagee on behalf of the lender or the investor in the original mortgage to accept a partial payment of claim.

This essentially means that the lender or the original investor who bargained in their contract with HUD, that they would either receive a full payment of claim in the event of a voluntary prepayment of the mortgage, or in the event of an involuntary prepayment caused by default, a 99 percent claim to simplify matters.

This would effectively restrict their options and require them to retain only a portion of that mortgage at its original interest rate, whether that were below market or above market.

We believe that this provision grants HUD the authority to abrogate its FHA insurance contract with these secured mortgagees as a tool to restructure the mortgage. We think this provision, frankly, reflects more a misunderstanding of the market reality and the relationship between the lender and investor and its service of a mortgagee.

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We believe also that this may, in fact, involve a breach of the contractual obligation, which would then embroil the financial and the capital markets and deteriorate, possibly, the performance of GNMA mortgage-backed executions in the future.

We think, frankly, that that is unnecessary. We are really taking a big baseball bat to a problem that probably can be solved with a very small hockey stick.

We really look forward to working with you.

Senator MACK. Some would indicate that more damage comes from a hockey stick.

[Laughter.]

Mr. NARASIMHAN. Senator, it depends on whose hands it is in.

But this is an objectionable provision. It is in reaction to a concern that mortgagees will somehow obstruct the process of permitting restructurings. First, we think that the current authorities given to HUD to declare, if they will, a default, and therefore do a full claim, already exists.

To permit this is to create a series of issues for the capital markets that are quite unnecessary. We would like to work with you and your staff to address this in such a way that we can actually address the problem without causing a subsequent problem.

Again, we are satisfied that you have addressed the role of mortgagees in the restructuring process. What we would like, because of the potential impact of the proposed legislation on the FHA fund, is to respectfully request that you include language to protect the fund from negative budget and credit scoring impact that could undermine its continued viability in the future.

If all the impacts of this restructuring were influencing future credit subsidies for new programs or new authorities to insure loans, it could significantly undermine the viability of what is at this point a functioning, viable, FHA's multifamily program dealing with all other subsidies.

We think there is language that we have proposed that, if incorporated, would address that issue.

Again, on behalf of the MBA, we would like to thank you for the opportunity to address these issues. We look forward to working with you and your staff and moving this process forward.

Thank you.

Senator MACK. Thank you for your testimony.

I want to say to all of you, how much I appreciate your comments this morning. There is no question that this Subcommittee and staff has tried to work with all the different interests in this issue. We began with our concern with what would happen to residents, to communities if we make the wrong types of decisions.

We have, obviously, a responsibility to protect the taxpayer, but at the same time, we also understand that there is a relationship that has existed as a result of owners' willingness to invest and to watch over these projects or communities.

Unfortunately, it is always those troubled projects that everyone hears about. Very few are ever focused on the literally thousands of community developments around our country that provide decent, low-income housing for so many of our citizens.

So, your involvement here today is crucial. I appreciate the special role that the mortgage bankers and financiers play, and the

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owners and States. Mr. Grow, I appreciate particularly your comments this morning. Again, we have tried to listen to all the aspects that have a mutual interest in this legislation.

I might start my questions, Mr. Grow, with you, and just talk a little bit more about this income mix issue that the Secretary raised. I have a tendency to agree with your comment that there is income mix existing in project-based Section 8 projects today. I would like a little bit more input, a little bit more thought as to how we respond to the Secretary's concerns.

Mr. GROW. Well, first of all, I think I want to avoid the danger of pitting continuation of project-based assistance against the voucher program. Both of the programs have strengths and weaknesses. Here, what we're talking about is whether or not project-based assistance on sound properties ought to be continued, or whether it ought to be replaced with vouchers.

One of the things that the proponents of vouchers sometimes cite is that it gives people more choice. Well, that's true, if you're in a housing market where choice exists. But also, choice is a two-edged sword. If some of these projects were converted to tenant-based subsidies, some tenants, would leave, not because of housing quality, but because of other reasons why people make choices. That will lead to instability in the housing development itself, which I don't think is a good thing.

But with respect to the narrow question of income mix, I think that when you look at the project-based portfolio, depending upon where the property is located, what the management has been, what the tenant selection policies have been, there will be a band of incomes represented in that development of both people on public assistance, people on Social Security, and people with employment income.

Many of these developments are mixed-income developments, although the average income does tend to be fairly low. People need to bear in mind in thinking about this that people with very low incomes are still—many of them are still working for a living at $10,000. Just because they're working hard for a living and making only $10,000, doesn't mean that these developments should not be available to that type of tenancy with a project-based subsidy.

Senator MACK. Mr. Koelemij.

Mr. KOELEMIJ. Senator, I might point out that we operate a 236 project where only 50 percent of the units are eligible for project-based subsidy. Of course, 236 has some interest subsidy, but we have a substantial mix of incomes because of that feature.

I further might point out that when we started in 1973, we had a good mix. You were allowed to let people live there who received no rent supplement or Section 8, which came later in the 1980's.

But it was not until the 1980's that we were told that because of lack of production, we should make our units only available to low-income people by preference. So we did what we were told to do. And now it takes some time to reverse that. It is not only that, it is the market that plays a role in the concept of the mind of people as to how you mix the populations. So it's a serious problem.

Senator MACK. I want to raise the issue of tax again. We did grapple with that over these past 2 years.

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As I indicated earlier, frankly, there was very little indication from Treasury that they were interested in any kind of tax component to this. Someone indicated a few moments ago that there is the very real issue that we don't have the jurisdiction over the tax issue. We could end up passing a piece of legislation that then would be—its effectiveness would be determined by some future action of some other Committee, and no guarantee that it would take place. So, that's one point.

The second point is that I think it's fair to say that the Secretary either specifically said or implied that the concept of soft-second mortgage would be something that would scare owners. I realize that the way it is structured clearly could have an effect, but I would like a little bit more input on this issue of the soft-second.

Mr. KOELEMIJ. Senator, I might say this, that we like your approach in your bill of a soft-second.

Senator MACK. When you say "we," this is the owners.

Mr. KOELEMIJ. We the owners or the homebuilders or the owners of a project. And the reason for that is this; the Administration's proposal could cause that the owner would be subject to greater tax liabilities if he goes into restructuring than if he does not participate in restructuring.

If he doesn't restructure and takes the risk of ultimately not being able to handle the mortgage, he has tax exposure equal to recovery of the original loan amount, not of the additional second mortgage which will accrue interest as well.

The proposal of the Administration also creates an unlevel playing field in making a difference between taxpaying and nontaxpaying buyers or purchasers of a project.

Third, it does away with the step-up basis, which has been an item in real estate investment tax laws for years. I think that under Mr. Archer's bill, it is being stressed that, for example, farm properties and small business ownerships cannot go to the family and cannot stay in the family, and that's the reason why they are doing something about adjusting the step-up basis features to diminish tax liabilities.

So, your approach, looking at it as an owner, gives me more security to enter the restructuring process than a bill that might never pass, or who knows how much of a Christmas tree it becomes when passed.

Mr. WALSH. Senator, if I may, we recognize that this structure ultimately has to receive the blessing of the Internal Revenue Service. And we would urge that whatever report accompanies this legislation be quite clear that it is the intent and the wish of the Congress that because the mortgages being restructured are divided into two parts, a first and a second, and at the same time, the Section 8 contract is being reduced to the level necessary to support the debt service on the first mortgage, this restructuring is being done to save money for the Federal Government and preserve the housing. This is not a refinancing done by the owner because he wants to take out additional funds. There is no economic gain to the owner in this restructuring. That being the intent of the restructuring, why should the owner be penalized by having a present tax event?

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Beyond that, why should he be penalized by having a tax event that's spread over 7 or 10 years when, in fact, it would spread over the life of the mortgage if he didn't enter into the restructuring?

The term of the mortgage is probably, in most cases, another 20 years. So, as I said in my earlier testimony and has just now been said, the owner is in a worse position, having come into the restructuring than if he had not come into the restructuring.

It doesn't take a rocket scientist to figure out how many owners are going to participate in the Secretary's program.

Senator MACK. Thank you.

Mr. Narasimhan.

Mr. NARASIMHAN. Senator, very briefly, the proposals in S. 513 offer the option to create something that, frankly, has already been done in the private markets. It does require a private letter ruling from the IRS.

It offers the capacity for recapture at some point in time for the Federal Government. While the Administration's tax proposal is a step forward in that it recognizes that the issue exists, it is both limiting, and, I think, in the long run, far too complicated for most owners to step forward on.

So, the solution really does exist, and proposals have been made to HUD over the course of the last 2 years through the demonstration program, on methods that might actually create the soft-second. I think the proposal that you have on the table, assuming that we have a degree of creativity, which may not exist at this time, would probably be well implemented.

Senator MACK. Mr. Grow.

Mr. GROW. I just wanted to add that it is also a very important vehicle for capturing the public benefit transferred here as a result of the restructuring. You've retained the soft-second held by the Government that will grow over time as it's deferred with interest. That then is a resource that can be used later on to encourage responsive performance by the owner downstream.

Senator MACK. Very good.

Senator Reed, I wonder if you would hold for a moment while Senator Kerry makes a statement.

OPENING COMMENTS OF SENATOR JOHN F. KERRY

Senator KERRY. I apologize. I wanted to be on the record.

First, I want to welcome Ms. Yeaton. Thank you for taking the time to be here today to share your thoughts with us on this, and I thank the panel as a whole. I apologize for my inability to stay, but we had a markup in the Commerce Committee, and I had to be there.

I just want to say that I am very supportive, Mr. Chairman, at this point, of our bill, and I want to thank you for accommodating a number of the concerns we have had. I would also like to thank your staff for working closely with Jonathan Miller and others on my staff to reach agreements on a number of issues.

A few months ago, we faced a very tricky set of choices on this. I think you have skillfully helped maneuver through some of that.

While there still may be some questions—I know HUD has a few reservations—I think, generally, we have been able to come to an agreement to do this in Reconciliation, which I support.

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Second, I think we all recognize State agencies' long-term expertise and concern for the public purposes of multifamily housing. The project-based issue has been a tough one for us. I think this is the best accommodation we can achieve, certainly, for the time being.

So, I look forward to the markup and working together as we go forward. Again, I apologize for not being able to be here longer. Senator Reed, thank you for your courtesy.

Senator MACK. I appreciate the pressure you're under today, and I appreciate your being here. It's just a continued evidence of your deep interest in these areas. Thanks for being here.

Senator Reed.

Senator REED. Thank you, Mr. Chairman.

Mr. Logue, the bill, S. 513, anticipates a very ambitious role for the State and local agencies. We in Rhode Island are very fortunate that we have the Rhode Island Mortgage Finance Corporation, which does a wonderful job. I'm just wondering, in general, should there be some language in the bill that provides some threshold qualifications to the agencies?

This is a rather complex task that they will be entrusted with. I would suspect that across the board, there may be some agencies that are not as capable as others. Should we be thinking along those lines?

Mr. LOGUE. Thank you, Senator.

In fact, the bill already provides basic criteria which any State housing agency or local housing agency would be required to meet to qualify to perform the tasks required under restructuring. We support that. We do not believe that HFA's or any entity by simple stature, without regard to basic qualifications, should automatically be entitled to do something that's as complicated as is envisioned in restructuring.

We believe the criteria incorporated in the bill right now are more than adequate to ensure that every State agency that has an interest to participate if qualified—and if the State doesn't qualify, then there are appropriate roles for other participants to perform that function.

But if a State agency is qualified under the criteria established by the bill, we believe that agency is the most appropriate agency. If it is willing, able, and meets the criteria to do it, the HFA is the most appropriate agency to perform the restructuring function in its State.

Senator REED. Another aspect of this debate has been the fact that the State or local housing finance agencies will not have any of their own resources at risk as they do this restructuring, which possibly could lead to a more generous attitude than the more sort of firm attitude in trying to negotiate some of these contracts. Should there be some risk sharing by the agencies if they are involved in these restructurings?

Mr. LOGUE. Well, I think the concept of risk in this situation is maybe a little bit misplaced. I think, first of all, there are significant risks for States which participate, not the least of which is getting involved in a process they do not have to get involved in, but have sought out because they feel it is part of their public mission to participate in this process and to effectively involve

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themselves in a restructuring of important and affordable housing resources within their State. States are seeking this out as part of their public mission. I think that's an important context to look at this in.

The resources that will be dedicated by State agencies, the ability to re-orient the activities of the agency toward this function, I think, are very significant, both financial and political risks for any State agency to take.

I do not believe that State agencies would be in a position to assume new risks that are right now the full responsibility of the Federal Government. But that isn't to say that State agencies wouldn't perform. They are performing. My own State agency administers 25,000 units of project-based Section 8 for HUD right now, very adequately—more than adequately, I think—exceptionally well.

We administer 15,000 of tenant-based vouchers and certificates, and, in fact, HUD calls us often when they have other local public entities that may not be capable or willing to do that job. They call on us to do it.

So we are performing that function in a way that I think is certainly more than satisfactory to HUD, currently. I believe this is the type—exactly the type of process that we should be encouraged to participate in, and which, in fact, most State agencies are very interested in participating in.

Senator REED. Thank you very much, Mr. Logue.

Mr. Grow, you mentioned in your testimony about the potential role of not-for-profit community-based organizations. I know, once again, in Rhode Island, they play a very crucial role.

We also have the assistance of LIHSC, the Low-Income Housing Support Corporation. Do you feel that as S. 513 is structured, that there are sufficient incentives to involve community-based, not-for-profits in the process?

Mr. GROW. Well, as I stated before, I think the bill makes a good start, first with respect to the properties owned by disqualified owners, requiring them to be transferred, and requiring owners to put up some capital for rehabilitation. That may encourage some owners to depart. The real problem here is that there is no positive incentive to encourage owners over time to leave the system. Now, that's not necessarily a bad thing. Some of these owners are very good owners.

The real question is, what is going to happen with the owners who can pass the screen and not get excluded, but really are in this solely for the management fees or some other income, rather than for the purpose of providing affordable housing.

The public policy has to focus on the stewardship for this stock. We have to make sure that the combination of the restrictions on the owner, the regulatory oversight system with the PAE's being involved, the residents being involved, making the PAE's accountable to the residents; that that's really going to produce responsive performance by the owners.

Now, I think at some point, owners are going to get tired and they're going to want to get out. That's why I think it's very, very important for the Federal Government to explore a comprehensive tax solution that encourages owners to leave in exchange for trans-

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ferring their properties to tenant-endorsed, nonprofit and public agency owners. That will be absolutely vital for the long haul.

Senator REED. So you would see that as a next step?

Mr. GROW. Yes.

Senator REED. But certainly this is a very positive step in S. 513?

Mr. GROW. Yes, Senator.

Senator REED. Thank you very much.

Thank you, Mr. Chairman.

Senator MACK. Senator Reed, thank you for your participation and interest in these issues. I have only really got a couple more comments to make, and then I think that we can wrap this up.

I want to go back again to the tax issue. During these past 2 years when we have been trying to work through these issues, you know, we haven't acted as if Treasury didn't exist. We have been engaged in discussions with them for some time. Actually, it was Treasury that recommended the use of the soft-second.

So, I'm not sure what is happening in the Administration with respect to this issue. But, again, we have tried to work with them. We have tried to figure out what was the best approach to take in working with Treasury over these past 2 years. In fact, they came up with the concept of the soft-second.

I think maybe just for the record, I ought to put in some information with respect to this issue about limiting HUD's authority in choosing the entity that would be handling these restructurings.

S. 513 provides the Secretary with the authority to select capable public entities that are determined to meet specific criteria related to management capacity, financial performance, and strength and expertise in affordable housing.

Further, public entities that qualify under the mortgage risk sharing and the fiscal year 1997 demonstration had to meet similar criteria. I realize that the point that the Secretary made, that the issues may not be the same, but the capabilities are fundamentally the same——

During this 1997 demonstration, it provided the Secretary with the authority to determine and select capable public entities. In fact, HUD has selected 42 State and local housing finance agencies in the process, which I would take, frankly, as an endorsement of this concept.

So, again, I just wanted to put that in the record.

I again say to all of you, thank you for your involvement. Thank you for your participation. We look forward to continuing to work with you.

The hearing is now adjourned.

[Whereupon, at 11:55 a.m., the hearing was adjourned.]

[Prepared statements and additional material submitted for the record follows:]

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PREPARED STATEMENT OF SENATOR WAYNE ALLARD

Thank you Mr. Chairman. As I stated at our hearing yesterday, I will vote for this measure because it is part of budget reconciliation, and we need to maintain our efforts to reduce spending. However, I do wish to make a few comments expressing my disappointment with the manner in which Congress continues to address Section 8 project-based assistance.

My hope is that this Subcommittee will begin to explore the fundamental reform of this program. It is true that we are moving toward the payment of market rents on these contracts, but that merely makes sense. Why should any developer receive a rent guarantee from the Government that is above market rent? As part of this we are deferring mortgage obligations. But what we are really doing is maintaining a failed system, and postponing the eventual problems into the future.

While we may be generating $1.6 billion in savings here today, we have included in the budget agreement an additional $35 billion in budget authority in order to renew these contracts. This seems to me to be some type of a shell game.

Yesterday, we had a Democratic HUD Secretary come before this Subcommittee and recommend that we move to vouchers on approximately 40 percent of these contracts. In fact, Mr. Cuomo is the third HUD Secretary in a row to push for more vouchers in these programs. Congress instead chooses to maintain the status quo.

Obviously, we would not voucher out the elderly, we would not voucher out the disabled. We would merely begin the process with maybe 10 percent or 20 percent of the contracts as they come up for renewal. We would give the tenants who want them a voucher.

The response to all this is that if we force the developers to actually compete for tenants, they will default and the taxpayers will be handed the bill. This might very well happen with some projects, and these are probably projects that should be shut down. But good projects will continue, and their quality will improve with competition. In addition, the loans on some properties will be purchased by new managers. Recently, GE Capital bought a number of these loans from the Government, the taxpayers recouped their investment, then tenants are better off, and the projects are run successfully without further drain on the Treasury.

So I would merely suggest that there are alternatives to simply maintaining the status quo. I believe they are good alternatives, and I hope we will begin to consider them with some hearings or discussions with HUD and other experts.

PREPARED STATEMENT OF SENATOR ALFONSE M. D'AMATO

Good morning. I would like to welcome Secretary Cuomo, Governor Thompson, and our panel of witnesses for coming here to provide their expert opinions on the "Multifamily Assisted Housing Reform and Affordability Act of 1997," S. 513.

We are here today in the spirit of bipartisan compromise in an attempt to work with the Administration to solve a housing and budget crisis in the Section 8 program. If not resolved, this crisis could negatively affect: Hundreds of thousands of our Nation's needy elderly, disabled, and hard-working families; the FHA Insurance Fund; State and local public agencies and bond markets; financial institutions; half a million affordable housing units; and ultimately, the American taxpayer.

This high-stakes housing crisis is not new to us in the Congress. In fact, the Banking Committee, Appropriations Committee, and Budget Committee have seen this train wreck approaching for some time. I commend the Secretary for finally submitting an Administration bill, which I introduced by request last week.

We have reached a bipartisan agreement in the Senate on a different bill—S. 513. S. 513 is a bipartisan, consensus bill that represents the culmination of over 2 years of information sharing, negotiation, and compromise between a wide range of interested parties.

I salute Senator Mack for tackling this difficult, complex issue and completing the absolutely daunting task of developing a solution with a breadth of support that runs the gamut from resident groups to financial institutions. I have a lengthy list here of organizations including many from New York that support this bill and it is very impressive.

It is the intention of this Committee to attempt to move this essential bill tomorrow. To that end, the Committee may markup S. 513 tomorrow and consider it as part of its reconciliation submission to the Budget Committee. This Committee and Congress must seize this opportunity to solve this crisis. I am pleased that the Administration recognizes the importance of moving this important process forward.

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Inclusion of S. 513 in the Committee's reconciliation package will allow us to exceed the Committee's savings target of $1.59 billion mandated by the Budget Committee and contribute even further to deficit reduction efforts.

I would also like to make specific reference to a support letter from the highly regarded New York Housing Conference. The New York Housing Conference is a 24-year-old, broad-based coalition of private and nonprofit developers, owners, and managers of affordable housing in New York. Its members include leaders in the financial, investment, and legal fields as well as affordable housing advocates, architects, and policy analysts.

Mr. Albert Walsh is here today to represent the Conference. I would like to offer a special thanks to Al for his significant contribution to the legislation before us. Al is an expert in real estate and public finance. He has a long history of public service to the affordable housing community in New York. On behalf of New York, I thank him for his years of dedication. I ask unanimous consent that the New York Housing Conference letter in support of S. 513 be entered into the Record.

In addition, the New York State Tenants & Neighbors Coalition, which represents the assisted and public housing tenants across the State, has also endorsed this legislation.

The opportunity to pass this desperately needed legislation now in the context of budget reconciliation should not be lost over policy differences or pride of authorship. Unless we fast-track a mark-to-market bill in reconciliation, it may never pass. I believe it is the view of this Committee that this critical legislation become law in the near future and without delay.

While the Administration's version of "mark-to-market" differs from S. 513, I believe all of us in this room today share the same basic objectives: Protection of the residents, reduction of Federal budget costs, and preservation of the housing stock.

I strongly urge everyone to work in the spirit of compromise throughout the reconciliation process to ensure that we take advantage of this important opportunity and pass S. 513.

PREPARED STATEMENT OF SENATOR MICHAEL B. ENZI

Good morning, Mr. Chairman. Thank you for holding this important hearing to examine the impact of changes in legislation affecting the affordable housing for thousands of American families.

I believe this legislation is a good start to help bring our fiscal house in order. This bill is estimated to save about $150 million in mandatory savings in 5 years. It will also rid assisted housing units of the bad managers and owners.

But let's not stop here. I believe the Government can save more scarce dollars by looking at other alternatives of housing for low-income residents. One alternative that I believe needs a much closer examination is a policy of moving toward more vouchering. Vouchers allow a resident to move to a location of their own choice. I realize the potential problems this could have on the Section 8 stock, with some stock facing a possible default. We cannot continue the current program, even with the passage of this bill, indefinitely into the future.

Currently, about $3.6 billion is being spent to renew all expiring contracts. This will grow to about $18 billion in fiscal year 2002. These figures show the importance of finding alternatives to the current policy. The cost of the expiring contracts is spiraling out of control, making it more difficult to balance the budget.

I commend the Chairman for his hard work on this bill. I look forward to hearing the testimony of the witnesses today to see how this legislation will affect all of the involved parties.

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STATEMENT BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS SUBCOMMITTEE ON HOUSING OPPORTUNITY AND COMMUNITY DEVELOPMENT

WASHINGTON, DC
JUNE 17, 1997

BY
SECRETARY ANDREW CUOMO

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Mr. Chairman and Members of the Subcommittee: Thank you for inviting me to testify on the very important matter of reforms to the multifamily housing programs and specifically on S. 513 and the Administration's bill, which was introduced by Chairman D'Amato as S. 853.

I am pleased to accept this opportunity to testify on legislation regarding the Nation's stock of Federally-assisted, privately-owned housing. I believe that solving the systemic problems facing the FHA-insured and subsidized portfolio is one of the highest priorities for the Department. We must work in a bipartisan fashion to address the longstanding problems facing the multifamily housing inventory.

If we work together, we can enact historic legislation this year. We need a strong bill that preserves affordable housing for the benefit of low- and moderate-income residents, treats project owners fairly, and protects the taxpayers. Failure to design appropriate and responsible mechanisms for how these reforms are carried out could cost the taxpayers billions of dollars and expose residents and communities to the loss of vitally needed affordable housing.

Let me begin by reviewing the status of and lessons learned under the fiscal year 1996 and 1997 Mark-to-Market Demonstration Programs and then proceed to a discussion of proposed new legislation.

The lessons learned from implementing the two Congressionally-authorized Demonstrations should be applied to any bill that addresses this complex problem.

The HUD's fiscal year 1996 Appropriations Act authorized HUD to conduct a Demonstration Program with respect to no more than 15,000 units and appropriated $30 million in funding. The Appropriations Act of 1997 authorized HUD to carry out a Demonstration Program with respect to no more than 50,000 units and appropriated $10 million in addition to the $30 million appropriated in fiscal year 1996.

Substantial progress has been made during the past year with regard to the 1996 and 1997 Demonstration Programs.

Of the 35 projects accepted into the 1996 Demonstration Program:

- 5 projects have closed.
- 6 owners are no longer interested.
- 12 projects are in active negotiations.
- 12 projects are on hold because the owners must seek approval of the local and State agencies that financed the FHA-insured mortgages.

To date, owners of 75 eligible projects have chosen to participate in the fiscal year 1997 Demonstration Program—a participation rate of about 50 percent. Due diligence is under way for all of these projects and preliminary restructuring negotiations are in progress for many of these. Additional projects will be added to the 1997 Demonstration Program over the next 4 months as contracts expire.

With regard to the fiscal year 1997 Demonstration Program, we have developed or completed the following:

- Published eligibility guidelines for projects entering the program.
- Developed a financial model to quantify the savings or the cost of potential loan restructure scenarios.
- Implementation of a field tracking system for all projects, credit subsidy and loan-related information to evaluate and control the program.
- Developed industry-benchmarked due diligence procedures for analyzing market and property conditions.
- Trained personnel from 10 field offices who will be assisting HUD's headquarters in the Demonstration Program.
- Selected 43 local and State housing finance agencies as designees.
- Issued guidance for local and State housing finance agencies regarding their roles as designees on a fee for service basis.

Working with local and State housing finance agencies and nonprofits is a key part of the Demonstration Program.

The Demonstration legislation provides the Department with the authority to enter into agreements with local and State housing finance agencies, nonprofits, and for-profits to carry out project restructurings on behalf of the Department. We focused first on local and State housing finance agencies. After a number of discussions with interested agencies, we published a notice requesting that interested agencies indicate their interest and qualifications by February 15, 1997. Forty-five days later we selected 43 local and State housing finance agencies for participation. We asked those agencies to provide us with management plans detailing how they would carry out project restructurings.

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To date, we have received management plans from the States of Ohio, Virginia, and Massachusetts, and from the city of Chicago. We have concluded discussions with Ohio and Massachusetts on their management plans, and have requested additional information from the other two public agencies and are waiting for responses. The State of Ohio has the largest number of projects eligible for the Demonstration this year.

In addition to local or State housing finance agencies, HUD is seeking partnership arrangements with nonprofit organizations, in which designees assume some or all of HUD's risk of restructuring. In exchange, designees will receive a share of the savings to the FHA Insurance Fund resulting from restructuring. The objective of this approach is to explore ways to significantly reduce HUD's administrative role while reducing claims to the FHA Insurance Fund.

Lessons learned from the Demonstration include the need to address the owners' concerns about timing, the tax consequences of restructuring, and the safe harbor provided by rents maintained at 120 percent of FMR.

We have learned a good deal from the Demonstration:

- We have found that owners typically have chosen to move slowly at all stages of potential restructuring.
- The restructurings take longer to consummate than originally planned.
- About half of eligible properties in fiscal year 1997 have chosen to accept rents at 120 percent of the Fair Market Rent rather than participate in the Demonstration—indicating a preference to wait for legislative initiatives that Congress may consider relative to future expiring Section 8 contracts and tax relief for the impact of debt restructuring.
- Some owners also have opted to wait based on their expectation that local market rents will rise.
- Because owners have been reluctant to participate without fully understanding all aspects of their expesure, we find that 180 days is not sufficient time for the entire restructuring process.
- The due diligence procedures of appraisal, market analysis, and physical needs inspection are very time consuming, and account for approximately 60 of the 180 day clock.

With regard to the fiscal year 1996 Demonstration, we have learned that, as negotiations progress, some owners find the tax consequences too onerous when weighed against the gains of the restructuring. They, therefore, choose to wait until more favorable conditions prevail. The fact that Section 8 contracts for properties in the fiscal year 1996 Demonstration have not yet expired may have added to the propensity to delay.

The universe of properties eligible to participate in fiscal year 1997 includes insured properties with contract rents above 120 percent of the Fair Market Rent. At the beginning of the fiscal year, we believed that this universe would number approximately 330 contracts. In fact, we found that owners of properties with rents below 130 percent of the FMR often found little incentive to participate in the Demonstration. They were able, instead, to tighten their belts and accept the rent reduction, while waiting to see what the rules would be next year.

It is clear from the experience we have gained from the Demonstration Program so far that many owners are waiting and watching to see what will ultimately happen with regard to the proposals that are now before the Congress.

The Administration's bill builds upon the lessons learned from the Demonstration as well as on the provisions in S. 513.

I would now like to turn to the Mark-to-Market provisions of the Administration's Housing 2020: The Multifamily Housing Reform, Consolidation, and Enforcement Act of 1997. This bill was introduced in the Senate by Chairman D'Amato and in the House by Chairman Lazio and Congressman Kennedy as H.R. 1433.

In an era of shrinking governmental resources, we cannot afford to continue to subsidize projects with rents in excess of market rents. Yet, as those over-market rental subsidies are reduced, many projects with FHA-insured mortgages supported by above-market rents will default, sending the bill for those defaults to the American taxpayer. Both the Administration's bill and S. 513 address this fundamental problem. Both bills also address the fact that the impact for tenants and communities could also be severe, as those projects able to survive in market conditions may be lost as affordable housing, while others will be abandoned and will blight communities.

The Administration's bill provides authority to HUD to operate a mark-to-market program to protect the financial interest of the taxpayer by simultaneously reducing over-subsidized Section 8 contracts and writing down the FHA-insured debt. The

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legislation would allow HUD to act quickly to reduce over-market subsidies, restructure project financing, provide funds for rehabilitation needs and protect tenants—rather than wait passively while costs mount and conditions worsen.

The bill includes tax legislation to ensure that adverse tax consequences do not deter owners from participating in mark-to-market. In exchange for favorable tax treatment, owners would preserve units at rents affordable to low-income families.

The Administration's bill and S. 513 share a number of key elements designed to protect residents and communities while also reducing budget costs:

- Reducing over-subsidized rents to market levels.
- Using designees to assist HUD in restructuring mortgages.
- Addressing the need to also rehabilitate deteriorated properties in the process of debt restructuring.
- Facilitating the voluntary transfer of ownership of a portion of this stock to resident organizations and nonprofits.

The Administration's proposal differs in a number of important respects from the previous proposals advanced by the Administration over the last several years:

- The new bill is a more balanced approach. The bill now includes the authority to provide project-based assistance in special cases, such as where tenant-based assistance would be difficult to use or where the project houses predominantly or primarily are elderly and/or disabled families.
- The bill reflects historic cooperation between the Treasury and HUD. The bill contains a well-targeted tax proposal to encourage proactive restructuring, which we believe is the key to making the process feasible.
- The bill is more flexible. All types of financing, including insured financing, are permitted. In addition, the bill provides a number of ways to rehabilitate projects where needed.

Both HUD's bill and S. 513 would exclude owners who have not carried out their obligations to the Federal Government from participating in any mark-to-market program.

Contracts should be renewed at current levels on projects that are financially vulnerable.

For mark-to-market projects, rents on restructured projects would not exceed market rents. For all other projects that are not eligible for mark-to-market, contract renewals in fiscal year 1998, in general, would be consistent with fiscal year 1997 provisions. That is, they would be renewed at current rents, not to exceed 120 percent of FMR, except that projects can be renewed at current rents above 120 percent of FMR if:

- The project's primary financing or mortgage insurance is provided by a State government and the mortgage is not insured by FHA.
- The project is a Section 202 or a Section 515, Rural Housing Service project.
- The project is eligible for mark-to-market but would not be financially viable at market rents, even with a complete write-off of the FHA-insured debt.

HUD's bill would protect the most financially fragile projects—those that cannot survive at market rents, even if all debt is written off—until we learn more about the best ways to protect those projects. These projects are found in rural communities where market rents are lower than the rents needed to operate these projects. They are also found in inner-city neighborhoods where, because of the need to pay higher operating costs for increased security and because of the characteristics of their tenants, projects have operating costs higher than market rents for unsubsidized projects. S. 513 does not protect these projects, but instead would require that they be included in a restructuring program.

Section 8 assistance must provide for resident choice while also protecting the most vulnerable residents.

HUD's bill would continue project-based assistance where the project is more than 90 percent occupied by elderly and/or disabled families. Project-based contracts would also be continued where the use of tenant-based assistance would be difficult because of tight market conditions, for example, communities with low vacancy rates. We estimate that over 50 percent of projects would continue with project-based assistance. Residents of the other projects would be provided tenant-based assistance at a level that would allow residents to remain in their current units.

The Senate bill would provide for project-based assistance on all projects that are restructured, regardless of whether it was needed or not. We believe that tenant-based assistance must be part of any proposal that addresses this problem. The Administration's bill protects vulnerable tenants, but allows other residents the right

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to exercise choice in where they live. Coupled with the requirements for tax amortization in our bill, this approach would expand the supply of affordable housing at a time when it is badly needed.

Efficient tax provisions must be included, so that owner concerns are addressed while protecting taxpayers and providing for long-term affordability.

As you are aware, owners whose debt is restructured face significant tax consequences as a result. These tax consequences are a formidable barrier to the voluntary participation of owners in a mortgage restructuring program prior to the expiration of their over-market Section 8 contracts. HUD and Treasury have worked together to craft a tax proposal that addresses the legitimate concerns of owners about the impact of debt restructuring while also protecting the taxpayers.

In the Administration's bill, taxes owed as a result of a restructuring transaction —that is, from debt forgiveness—would be amortized over a period of up to 10 years, rather than being due immediately. Incentives would also be provided to owners who sell projects to nonprofits.

In exchange for favorable tax treatment, owners would agree to maintain 40 percent of the project's units at rents affordable to families who earn 60 percent of the median income or less. These affordability restrictions match the eligibility requirements for the Low-Income Housing Tax Credit. In order to ensure that the owner can provide these affordable units without endangering the project's financial stability, FHA will write-off or forgive *sufficient* debt to reflect the reduced income from those units.

The Senate bill lacks a similar comprehensive tax provision, but instead provides for the bifurcation of the FHA-insured mortgage into a performing first mortgage, and a nonperforming second mortgage repaid only after the first mortgage is repaid. The nonperforming second mortgage would accrue interest at the Applicable Federal Rate. Over time, the second mortgage would balloon in size to double, triple, quadruple its original amount, because of the accrual of interest.

The second-mortgage provision of S. 513 poses a significant risk to the future viability of restructured projects. Accruing second mortgages would grow so large that the owner has no hope of repaying it, and would consume all of the project's equity. The owner would then have no financial incentive to maintain the property, exposing the taxpayers and residents to the dangers of severely dilapidated properties.

In addition, the Treasury Department notes that the second-mortgage provision of S. 513 poses a very serious problem for the owners from a tax perspective. The bifurcation of the mortgage will result in an immediate tax liability for the owners if the second mortgage is not respected as valid indebtedness for tax purposes. In light of the terms of the second mortgage and the expectation that the owners would have no hope of repaying it, the second mortgage would most likely not be respected as valid indebtedness. As a result, the restructuring provision of S. 513 would effectively create immediate taxable income for the owners in an amount equal to the second mortgage. In short, while this provision purports to address owners' tax problems, it is unworkable—thus defeating the larger purpose of the legislation.

Restructuring must be done with a range of tools, so that it can be accomplished in a way that protects taxpayers and residents.

The Administration's bill would authorize a range of tools to restructure a project so that it would be financially viable, including the complete or partial write-off of the FHA-insured mortgage. The owner could choose whether or not to retain FHA insurance on the restructured mortgage.

- HUD would establish procedures to ensure that local governments, tenants, and the holder of the insured mortgage receive timely notice of the owner's participation in the restructuring process.
- Third parties would be authorized to carry out the restructuring and HUD could use designees by delegation, contract, cooperative agreement, or other arrangement. The designees could be State and local housing agencies and nonprofit or for-profit entities.
- The Secretary would establish procedures to encourage the sale or transfer of a project, or the transfer of the management of a project, to tenant organizations, community-based nonprofits, and public agencies.

The Administration's bill recognizes the constraints on HUD's existing staff by authorizing the use of designees to act for the Department in restructuring cases. HUD proposes to enter into arrangements with designees to carry out restructuring activities and to rely on expertise available outside of the Department to accomplish its mission during a time of diminished resources.

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The Administration's bill authorizes State and local housing agencies and nonprofit and for-profit groups to be designees. The designees may be reimbursed and may work separately or in conjunction with one another. These designees will be accountable to the Secretary of HUD and will be selected based on capacity.

S. 513 provides HUD with the authority to contract with designees, but would limit HUD to using only designees that are local and State housing finance agencies and would constrain HUD's ability to choose qualified designees. It would also severely constrain HUD's ability to provide adequate oversight to ensure that taxpayers are protected as local and State agencies act on HUD's behalf.

I would like to quote from a letter written by HUD's Inspector General on this issue. She wrote on June 25, 1996 to the Subcommittee to convey her comments on a Senate discussion paper on a strategy for addressing this portfolio, including the primary reliance on local and State housing finance agencies to carry out the restructurings. The Inspector General wrote: "While there are many well performing SHFA's (State Housing Finance Agencies) and other similar public and nonprofit entities, there is reason to doubt whether there would be sufficient such entities that are qualified, able, or interested in taking on the responsibility of restructuring HUD's portfolio. There is also reason to doubt whether these entities would ensure that the best financial choices are made on behalf of the Federal Government, without close oversight."

This portfolio has significant repair needs, which, if left unteuded, pose an enormous liability for taxpayers, residents, and communities.

With regard to rehabilitation, the Administration's bill would finance needed repairs through a number of means. Owners would have to apply project reserves and residual receipts to rehabilitation. Rehabilitation costs could also be funded as part of restructuring, through refinancing or write-down of the existing debt or, when required, grants from the FHA Insurance Fund. In addition, the Interest Reduction Payments could be continued on restructured or refinanced 236 projects to pay for rehabilitation.

The Senate bill recognizes the need for rehabilitation of this portfolio, but does not include the use of Interest Reduction Payments to fund rehabilitation, a worthwhile use of that funding when it is no longer needed to support the restructured mortgage. S. 513 limits rehabilitation to $5,000 per unit, a number which will be too low for many projects. Although we support the need to exercise prudence and cost control over any decisions about rehabilitation, we believe that a higher rehab cost cap might be considered in light of the actual physical condition of this portfolio.

Any legislation must be implemented quickly.

The Senate's bill would require the use of negotiated rulemaking to develop regulations for the program. Negotiated rulemaking could potentially lead to gridlock on the development and implementation of regulations. Projects will expire while HUD attempts to reach consensus with affected parties. We believe that the Department should use notice-and-comment rulemaking to develop regulations for the program, which will provide all interested parties with the opportunity to comment on the program regulations.

Bankruptcy reform is an important part of efforts to restructure multifamily housing.

Both the Administration's bill and S. 513 include provisions that would strengthen the Department's ability to take actions against bad owners. S. 513 does not include an important provision, however, that would amend the Bankruptcy Code governing the powers of a bankruptcy court.

These changes would allow HUD to proceed in a timely manner with foreclosure actions and to take all necessary and appropriate measures to protect the property, the FHA Insurance Fund, or the residents of the HUD-insured or HUD-assisted multifamily housing projects from the potentially adverse impact of mortgagor bankruptcies. Bankruptcy reform will help the portfolio restructuring process by minimizing delaying tactics by negligent owners of assisted housing.

It is time to work together to pass a bill.

The Administration's bill and S. 513 are in many respects very close; but, clearly, substantial work remains for us to produce a successful bill. Let us make a commitment to resolve the remaining issues in a way that will protect the taxpayers, residents, and communities. With bipartisan effort, we can pass a bill that will put a significant portion of the FHA-insured and Section 8-subsidized portfolio on a much sounder footing for the difficult years ahead. I invite you to work with me to achieve that goal.

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PREPARED STATEMENT OF TOMMY G. THOMPSON

GOVERNOR OF WISCONSIN

ON BEHALF OF THE

NATIONAL GOVERNORS' ASSOCIATION

JUNE 17, 1997

Mr. Chairman and Members of the Subcommittee, good morning. I am pleased to be with you today, and I thank you for the opportunity to express the views of the Nation's Governors on the issue of expiring Section 8 contracts.

We want to commend Senator Connie Mack for introducing the "Multifamily Assisted Housing Reform and Affordability Act of 1997." S. 513 is an important step toward resolving the looming crisis in the Section 8 Project-Based Assistance Program. The Nation's Governors are pleased that Congress and the Administration are working to find timely solutions that preserve the affordability and availability of low-income rental housing while reducing long-term program costs. We look forward to significant State involvement in restructuring and monitoring Section 8 contracts. The Governors' Association support many of the provisions included in S. 513, though we would like to see some additional flexibility granted to the States. We are especially pleased that the Senate is addressing this issue so promptly, and we urge Congress to act very quickly to ensure passage of legislation this year.

Ensuring State Participation in Contract Restructuring

Any plan to restructure project-based Section 8 contracts will be necessarily complex and time consuming. So why would Governors and State governments want to be involved in restructuring efforts? The most basic answer to this question is that Governors share with the Federal Government a belief in the importance of providing decent, safe, and affordable housing for low-income families and individuals. This partnership is the basis of the HOME Program, the Low-Income Housing Tax Credit, and the Mortgage Revenue Bond Program, all of which are key to State efforts to promote affordable housing.

Failure to renew expiring contracts or address the financial viability of projects experiencing rent decreases could diminish the Nation's affordable housing stock and displace thousands of very low-income tenants. Make no mistake, this issue has a very human face. In my State of Wisconsin, our Housing Finance Authority oversees a Section 8 portfolio that serves 17,000 residents. Approximately 76 percent of these residents are elderly and rely on Social Security as their only source of income. In fact, their incomes average only $8,200 per year. Project-based Section 8 is the only program standing between these poor, elderly tenants and the street. The excessive costs of the program must be addressed as a matter of fiscal responsibility, but also to ensure that the cost of Section 8 does not limit funding for many other Federal-State housing programs. Clearly, Governors and States would face substantial problems if contracts are not restructured correctly and quickly.

Due to downsizing and limited capacity, the Department of Housing and Urban Development (HUD) will not be able to renegotiate and restructure all of the thousands of Section 8 contracts expiring in the next several years. The restructuring process represents an extraordinary burden, and it would be difficult for HUD to address all expiring contracts while running all its other programs. Congress recognized that HUD needed help and that States are the logical partners to provide this help when it set up the 1997 Portfolio Reengineering Demonstration Program. At the 1997 winter meeting of the National Governors' Association (NGA), the Governors adopted a policy expressing the States' interest in playing a major role in the Demonstration Program. A copy of that policy is attached.

It is because the Governors and the Federal Government share a commitment to providing affordable housing that States are in a strong position to help HUD restructure contracts. State agencies possess the experience and expertise needed to perform the complex task of restructuring. Moreover, State agencies know local housing and finance markets and are well qualified to make the judgment calls that will be necessary as each project is renegotiated. State agencies also have the necessary skills to monitor long-term compliance with newly-negotiated contracts. The Governors appreciate the primary role given to States by S. 513.

Protecting State Resources

It is essential that existing obligations of the Federal Government to these State-financed projects be honored, because Federally-mandated changes would jeopardize States' ability to meet their financing obligations under outstanding bonds. Federal changes could have serious consequences for all future State-financing capacity by

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eroding credit ratings and increasing the cost of borrowing. S. 513 protects such projects, and the Governors urge that these provisions be maintained.

The Governors appreciate the proposed bill's commitment to share money saved by restructuring with the States. Many of the Reinventing Government programs that I have implemented in Wisconsin are based on this type of incentive. Shared savings provide ownership, authority, and responsibility that help to increase the chance of success.

The Governors also commend the sponsors of S. 513 for recognizing that the Federal Government, not the States, is responsible for the financial liabilities of the Section 8 program. The States neither are willing nor able to take over the Federal Government's financial responsibilities. Although States are willing to help solve the problems in the Section 8 program for the many reasons I have already stated, Section 8 project-based assistance is a Federal program and its problems ultimately are the responsibility of the Federal Government.

Needless to say, States need to be compensated for reasonable expenses incurred during the restructuring process. S. 513 allows for such compensation.

Providing for Flexibility

To be successful in restructuring contracts, States need the authority to use as many tools as possible and need adequate time to process all contracts. Ideally, States should have a say in whether Federal insurance will be provided to a project. S. 513 authorizes a wide variety of restructuring tools that States or other entities can use in performing restructurings, including full or partial payment of mortgage debt, refinancing of debt, and the provision of Federal Housing Administration Insurance. The Governors support maintaining these provisions.

Another key aspect of flexibility is the authority to set rent levels. S. 513 places an absolute cap of 120 percent of Fair Market Rent on all restructured properties. Further, the bill allows a State to approve rents between 100 percent and 120 percent of Fair Market Rent on only 20 percent of the units in the State. Although the cost-saving justification for these provisions is understandable, it is equally important to recognize that these caps could limit States' ability to adequately resolve expiring contracts. The Governors urge the Subcommittee to eliminate the cap of 120 percent of Fair Market Rent. Or, at a minimum, we urge you to increase the cap and provide for streamlined waiver authority.

Additional flexibility is also needed in the provisions of S. 513 that require the owner of a project to perform necessary rehabilitation as part of the restructuring process. Maintenance and repair of projects is an essential part of providing quality housing. The $5,000 per-unit cap on rehabilitation assistance may be insufficient to cover the costs of repairing some units. State efforts would be enhanced if the cap on rehabilitation costs were eliminated from S. 513 allowing decisions about rehabilitation assistance to be made by the State or entity performing the restructuring.

Preserving the Affordable Housing Stock

Preservation of the affordable housing stock is an important goal for Governors. Continuing to provide project-based Section 8 assistance is one way to ensure that the current inventory of affordable housing is not lost. Tenant-based assistance empowers recipients by allowing them to choose where they will live. Both forms of assistance promote important public policy goals. However, the Governors are concerned that conversion of a significant amount of current project-based assistance into tenant-based assistance could both deplete the housing stock and decrease the ability of States to effectively restructure expiring contracts.

Considering the Views of Project Owners

Everyone involved in the debate over renewing project-based Section 8 contracts understands that owners must have some incentive to come to the bargaining table. Otherwise, they may withdraw from the program when their contract expires or halt the restructuring process midstream. Ideally, owners should also have a reason to renegotiate before their contract expires. Both S. 513 and HUD's legislative proposal address the tax problem created by mortgage writedowns. However, State housing agencies, which I hope will be playing a major role in contract restructuring negotiations, are concerned that some problems may still exist. The Governors urge the Subcommittee to continue working with owners on this issue.

Conclusion

In closing, I would like to emphasize once again the Governors support for the basic structure of S. 513. We look forward to working with the Subcommittee to increase the flexibility provided to States and other entities that are renegotiating contracts.

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The Governors have a strong interest in having States perform contract restructurings as States are uniquely qualified to partner with the Federal Government in this effort. We appreciate the primary role given to States in S. 513. We also appreciate the fact that this Subcommittee is addressing the Section 8 crisis so promptly. The risks are too great for all of us if Congress does not pass legislation this year.

Again, I thank you for the opportunity to share the Governors' concerns on this important issue.

Attachment: NATIONAL GOVERNORS' ASSOCIATION AFFORDABLE HOUSING POLICY

NATIONAL GOVERNORS' ASSOCIATION

NGA Policy

EDC-14. AFFORDABLE HOUSING

14.1 Preamble

The Governors support the integration and coordination of public and private resources to make available effective, affordable housing services that range from preventing homelessness to promoting homeownership and that encourage self-sufficiency and promote economic opportunity. States and local governments should be able to use affordable housing resources to help end welfare dependency. As major partners in the affordable housing arena and as managers of a significant proportion of human services program dollars, states are in a unique leadership position to coordinate these resources in an effective way to end welfare dependency and promote economic self-sufficiency.

14.2 Percent Cap on Rental Payments

If Governors are to succeed in implementing welfare reform, programs and practices in other federal programs must support this effort, and disincentives for moving from welfare to work must be minimized. The inflexible requirement that 30 percent of income be paid as rent is a disincentive, and raising the cap higher would be particularly harmful to the success of welfare reform, as well as potentially shifting costs to the states.

14.3 Existing Programs

The HOME Investment Partnerships Program (HOME) and the Community Development Block Grant (CDBG) provide successful and proven models of a state-federal partnership that can be used in other housing and development areas. HOME was designed as a federal/state/local program, with states receiving a substantial share of the funding, having the flexibility to fit HOME funds into the full range of housing services, and having the authority to spend funds anywhere within a state rather than only in rural areas. As efforts to streamline and consolidate programs continue, Congress and the administration should use these partnership aspects of the HOME program as a model.

The Governors also recognize the importance of mortgage revenue bonds, mortgage credit certificates, and the low-income housing tax credit, which are critical to the continued availability of affordable housing, and oppose efforts to remove the permanency of these programs. These are models of effective federal housing programs administered by the states. Therefore, the Governors support increases both in the state private activity volume caps and in state allocations for the tax credit because inflation has seriously eroded their capacity. The Governors ask that increased flexibility be provided in the tax credit program, to permit more of the funds to be used to promote homeownership, as well as in the use of proceeds of tax-exempt housing bonds. These changes would give states more programmatic flexibility to address future demands for housing assistance as federal programs are restructured.

14.4 Federal Housing Efforts

The Governors urge Congress and the administration to work more closely with states to address the following priority issues.

- Consolidate programs and streamline program administration to better effect local control, ensuring that existing contracts are adequately resolved, and to increase flexibility for states in administering federal programs, including authority for states to use existing legislative or regulatory procedures wherever possible to achieve federal program goals.

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- Promote programs that are leveraged with private sector funds, that preserve the affordable housing stock, that increase the use of new technologies to lower housing costs, and that remove unnecessary regulatory impediments to the construction of affordable housing
- Develop consistent definitions and eligibility criteria, remove set-asides and rigid planning requirements, and focus on output measures rather than detailed planning documents.

Beyond these recommendations, the Governors urge the federal government to strengthen efforts to increase homeownership. One approach is to strengthen the public/private partnership. For example, the federal government should study effective incentives to increase the construction of affordable "starter" homes, work with states and localities to identify unnecessary barriers to the construction of affordable housing, and consider other steps that might unleash the resources of the private sector in the pursuit of homeownership.

14.5 Section 8 Project-Based Assistance

The Section 8 program involves a federal commitment of rental assistance to owners of federally assisted properties that house low- and moderate-income families. Some of these properties have long-term federally insured mortgages. Others have uninsured, state-financed mortgages backed by state-issued bonds. The Governors ask that existing obligations of the federal government to state-financed projects (continuing contracts) be honored, because changes would jeopardize states' ability to meet financing obligations under outstanding bonds. Federal changes could have serious consequences for all future state-financing capacity.

Regarding expiring contracts, the U.S. Department of Housing and Urban Development is currently testing a method of restructuring contracts to reduce continuing federal subsidy costs. States could be willing to play a major role in developing restructured contracts with project owners in order to save the federal government from the cost of defaults on federally insured properties, protect the limited stock of affordable housing, and avoid displacement of low-income residents. State involvement will increase as states are permitted to share in the resources saved in the restructurings. However, to be successful, states need flexibility and authority in many areas, including directing federal resources such as continuing Federal Housing Administration insurance. This authority and flexibility also is needed to ensure that restructuring does not result in added state financial responsibilities. Flexibility also should ensure adequate time to conduct restructuring, especially in states with large numbers of units under expiring contracts.

14.6 Programs Serving the Homeless

In the past, Congress has considered legislation to block grant federal programs for the homeless. The Governors support consolidation, ask that these programs be adequately funded, and ask that efforts to streamline and consolidate federal programs to serve the homeless and to prevent homelessness include an effective state role.

Time limited (effective Winter Meeting 1997–Winter Meeting 1999).
Adopted Winter Meeting 1995; revised Winter Meeting 1997.

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PREPARED STATEMENT OF JAMES LOGUE, III

PRESIDENT, NATIONAL COUNCIL OF STATE HOUSING AGENCIES
ON BEHALF OF THE
NATION'S STATE HOUSING FINANCE AGENCIES

JUNE 17, 1997

Chairman Mack, Senator Kerry, and Members of the Subcommittee, thank you for this opportunity to testify.

The National Council of State Housing Agencies (NCSHA) is a national, nonprofit organization created in 1970 to assist its members in advancing the interests of lower-income and underserved people through the financing, development, and preservation of affordable housing. NCSHA's members are Housing Finance Agencies (HFA's) with Statewide authority. NCSHA's member agencies operate in every State and the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.

Mr. Chairman, NCSHA commends you and your colleagues, Senators D'Amato, Bond, and Bennett, for taking the lead in Congress to preserve our Nations' affordable housing stock and to protect its low-income residents. We applaud you for introducing the first and the most well-constructed legislation (S. 2042) to address permanently the need for restructuring FHA-insured mortgages and renewing the thousands of expiring Section 8 project-based contracts which support them.

We thank you for involving the State HFA's in the development of this critical piece of legislation, which you reintroduced this year as S. 513. Thanks to your extraordinary efforts to reach out to the entire affordable housing community, this bill is a consensus product. It reflects the perspectives and has the support of those who live in, own, manage, and finance this assisted housing.

We share your sense of urgency to move this legislation as quickly as possible this year. The time is now for Congress to deal definitively with the Section 8 crisis. Contracts assisting 646,000 units expire this year. Contracts assisting another 1.8 million units will expire next year. The number of units with contracts expiring will continue to grow over the next 5 years, reaching 2.7 million in 2002. Failure to renew these contracts will force residents to face sharp rent increases, displacement, and eviction. Property revenues will be reduced sharply, resulting in high rates of default and FHA claims.

Mr. Chairman, you clearly understand the sweeping implications of the Section 8 contract renewal crisis. We as a Nation cannot afford to continue to renew all expiring contracts at current rents, but we also cannot afford to turn our back on the Federal Government's enormous investment in this irreplaceable housing stock and its residents. Your bill would achieve Federal budgetary savings. You recognize, however, that this is not just a budget exercise. Unlike alternative approaches, your legislation also would put the housing on sound financial footing, preserve it as affordable for the long term, protect its residents from harsh rent increases and displacement, and contribute to neighborhood stabilization and revitalization. Your strategy would accomplish all of this while respecting the rights of States, owners, lenders, and investors. Your approach is the right approach.

HUD and Private Sector Entities Are Inappropriate Restructuring Agents

Mr. Chairman, your legislation recognizes that HUD lacks the staff, resources, and capacity necessary to effectively handle the restructuring of Section 8 contracts. The General Accounting Office (GAO) has cited HUD as a "high risk" agency since 1994 because of the Department-wide deficiencies making programs vulnerable to waste, fraud, abuse, and mismanagement. The GAO reported that longstanding problems such as weak internal controls, inadequate information and financial management systems, and an ineffective organizational structure continue to affect HUD's performance. Furthermore, in light of severe budget constraints, Secretary Cuomo has announced his intention to downsize the HUD's staff from 10,400 to 7,500 employees by the year 2002.

Even HUD admits it does not have the resources to handle Section 8 restructuring on its own. In its multifamily housing bill (H.R. 1433), HUD responds to its lack of capacity by proposing to contract with both private and public sector agencies. Unfortunately, HUD's legislation fails to draw adequately upon the expertise and public purpose mission of HFA's by giving them priority for handling property restructuring. Instead, HUD's proposal would rely heavily on the private sector. The use of private entities is inappropriate and poses a dangerous risk to the preservation of the housing stock as affordable and the protection of low-income residents. Unlike the HFA's, private firms are motivated purely by profit, not public service. We are deeply concerned about HUD's proposal, and seriously question HUD's com-

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mitment to partnering with HFA's to any significant extent. We urge you to reject HUD's approach decisively.

Maintain Priority for State HFA's to Handle Restructuring

Mr. Chairman, the State FHA's urge you to continue to insist on the priority your bill establishes for qualified HFA's to handle Section 8 restructuring. HFA's are ready, willing, and uniquely able to take on this challenge.

This Congress is dedicated to devolving responsibility for decisionmaking as much as possible from the Federal Government to States and localities. We agree that returning authority for public policy implementation to State and local governments in many cases will yield better performance and results than the Federal Government has produced. HFA's are highly qualified to assume HUD's responsibilities and create superior outcomes in the restructuring process, and will be there in years to come to work in partnership with property owners, managers, and residents.

HFA's are permanent, quasi-public institutions chartered by State governments expressly for the public purpose of creating and preserving decent, safe, and affordable housing in a fiscally responsible manner. Most State HFA's have over 25 years of experience in financing affordable housing throughout our States. Each HFA has a stake in the Section 8 portfolio in its State, because of its commitment to providing affordable housing opportunities in this time of scarce resources and expanding need, and because the future of these properties inevitably will affect neighboring properties.

HFA's will work to reduce the costs of the Section 8 programs, while remaining true to our mission of providing decent, safe, and affordable housing. HFA's understand the importance of that scarce resource and will strive to restructure the financing in ways that accomplish both the public purpose of providing good quality housing and the objective of reducing Section 8 costs.

HFA's operate as self-sustaining, efficient businesses, reinvesting our revenues in affordable housing programs. For that reason, we seek reasonable compensation for assuming responsibility for the restructuring process. Make no mistake, however, about our motivation for handling this process. The HFA's have no expectation that restructuring will be a profit-making venture. In fact, the uncertainties involved in unraveling the complex financial structures supporting these properties pose a real risk that HFA's may not be able even to cover our costs in this process.

Unlike private sector entities, HFA's are publicly accountable. HFA's were established by State legislatures or Governors. HFA's are subject to oversight and audit by State governments. HFA's boards of directors are appointed by Governors or other elected officials, and often include elected State officials among our members.

In contrast with private firms, HFA's are permanent institutions devoted exclusively to the financing and long-term administration of affordable housing programs. We are deeply dedicated to working with the residents of properties we finance and the surrounding communities. HFA's are very familiar with the interests of these communities, and have experience in providing forums for resident concerns and coordinating services and funding sources to benefit residents. The longstanding commitment of HFA's to our public purpose and high performance has helped us earn the trust of our citizens.

HFA's possess the financial expertise and the experience necessary to analyze and best respond to the legitimate financial needs of Section 8 properties. Most HFA's have almost three decades of experience in housing finance, development, underwriting, rehabilitation, asset management, compliance monitoring, auditing, and related legal work. HFA's have a proven track record in outstanding loan servicing and management of our subsidized housing stock. The careful monitoring of HFA's properties through financial accountability and prudent resource allocation has contributed to the viability and longevity of these properties. HFA's-financed properties have exceptionally low incidences of default and foreclosure. The private sector investment community acknowledges the sound underwriting and monitoring experience of HFA's through consistently high bond ratings.

HFA's underwriting expertise includes significant experience with complicated financial workouts similar to those that will occur with restructuring. Most HFA's possess the full range of technical resources necessary to analyze, restructure, and reposition affordable housing developments. HFA's also know the housing markets, demographics, and particular needs of our States and communities, making us most qualified to assess the short- and long-term implications of restructuring and repositioning Section 8 properties.

For example, the Florida Housing Finance Agency recently assisted two multifamily properties whose bonds were in default by structuring a refunding of existing bonds through the issuance of $15.6 million in non-rated tax exempt bonds. The sale of these bonds enabled the developer to redeem the existing defaulted bonds. In ad-

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dition, the refunding eliminated the Resolution Trust Corporation's (RTC's) exposure to the existing bonds. Since 1991, the Maryland Department of Housing and Community Development (MDHCD) has supplied over $12 million in bonds, over $3.5 million in development funds and write-down assistance to help stabilize the five properties at risk of defaulting on their mortgages. The Department also provided resident services and worked closely with local governments to help bolster these properties. Maryland's assistance helped reduce the FHA insurance claims for properties with Section 236, Section 8, and 221(d)(4) Federal assistance.

HFA's are experienced in working in partnership with the Federal Government and monitoring owner and manager compliance with Federal housing programs, including HOME and the Low-Income Housing Tax Credit (Housing Credit), and in Section 8 contract administration. Many HFA's have administered Section 8 contracts throughout their 20–year terms, assuring sound physical and financial condition of the properties, and managing subsidy payments on HUD's behalf.

Through the administration of Federal programs, HFA's have proven our ability to responsibly ration precious and diminishing Federal resources while leveraging other resources for meeting our States' housing needs. HFA's have access to both Federal and State resources not available to other potential designees. These resources may include funds from the agency itself, the State government, HOME, CDBG, Housing Credits, foundation grants, and funds borrowed from the Federal Home Loan Banks (FHLBanks), Fannie Mae, Freddie Mac, or the AFL-CIO. HFA's also work in partnership with social service providers, State nonprofit networks, and local governments, which could enable us to enhance resources and services available to Section 8 properties and residents throughout the restructuring process.

HFA's bring to restructuring familiarity with the third parties in our States which would carry out contract services such as appraisals, physical needs assessments, and legal services with strict HFA's oversight. Unlike HUD, whose contracts with large, national contractors often have produced weak results and allegations of corruption, HFA's have demonstrated our ability to evaluate and oversee the most appropriate use of local contractors with specialized expertise. For example, under the loan sales program with HFA's, HUD has admitted that HFA's due diligence produced more accurate needs assessment and market studies than HUD's contractors.

HFA's also have longstanding business relationships with property owners and managers in our States. HFA's ensure that owners and managers meet agency objectives and program criteria, through careful oversight and efficient allocation of scarce resources. Owners and managers have strong incentives to meet HFA's standards, because they want to continue our long-term beneficial business partnerships. These established relationships enhance HFA's ability to work with property owners to develop preservation strategies for troubled properties that are mutually acceptable and advantageous. Conversely, because we know the owners and managers in our States, HFA's can differentiate between the honest and the unscrupulous. HFA's have longstanding systems in place for identifying negligent owners and managers, enforcing compliance standards, and imposing sanctions, including removing inadequate owners and managers when necessary. HFA's have no tolerance for corrupt or inept owners or managers who take advantage of housing assistance programs at the expense of low-income residents and taxpayers.

HFA's Have Demonstrated Our Interest in Handling Restructuring

Mr. Chairman, as you know, Congress fully recognized HUD's limits and State HFA's abilities when it enacted the fiscal year 1997 Section 8 Restructuring Demonstration last September in the fiscal year 1997 VA-HUD appropriations bill. Modeled on your bill, Congress designed the Demonstration to rely significantly on HFA's—not privateers—to assume HUD's responsibilities for property restructuring wherever possible. As in S. 513, the Demonstration gave HFA's a priority role to serve as HUD designees. Thirty State HFA's, with three-quarters of the eligible properties, applied and have been approved by HUD to serve as designees.

These HFA's have been eager to get started for many months. Since last fall, NCSHA has made every effort to help HUD define the HFA's role under the Demonstration, providing detailed comments to HUD, and convening many meetings and conference calls to allow HUD and HFA's to communicate and exchange ideas. Nevertheless, HUD has been extremely slow to get the program up and running. Regrettably, HUD has focused much of its time and its attention on readying its own field staff to carry out the restructurings Congress intended for public agencies and nonprofits.

After 4 months, HUD finally preduced the program guidelines in late January. After 3 additional months of delays, HUD finally issued specific instructions for HFA's in mid-April. In other words, it took HUD nearly 7 months from the enactment of the legislation to provide HFA's with fundamental guidance on how their

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role would be structured. Throughout this entire period, HUD repeatedly promised to provide this information to HFA's in short order, and failed to produce it. On several occasions, after months of delays in producing drafts of key materials for HFA's comment, HUD requested written feedback virtually overnight. Until this week, HUD had not provided the HFA's with essential financial analysis models and the software necessary to measure how much specific restructuring plans will cost the Government, or copies of the draft contracts it will ask HFA's to execute to become designees.

HUD's lack of responsiveness to HFA's interest in getting the Demonstration underway has been exacerbated by a lack of consistency in the HUD's staff dedicated to implementing the Demonstration. Since September, administration of the program has been handled successively by two program coordinators contracted on a temporary basis, with assistance from outside consultants. The first coordinator served from April through November 1996, dividing his time between Washington and his home in Los Angeles. The second coordinator began in November and will be leaving HUD at the end of this month. HUD has not yet named her replacement. The short tenure of these employees and the temporary nature of their assignments has added to the confusion and uncertainty associated with HUD's management of the Demonstration.

HUD's consistent delays in producing guidance for designees, its tendency to focus primarily on the role of field offices in restructuring, and the overall lack of cooperation which HFA's have encountered in the Demonstration has led us to question whether these obstacles can be attributed solely to the Department's bureaucratic operations and weak management. We have begun to suspect that HUD is deliberately resisting giving a priority to HFA's in restructuring, as your bill intends and Congress directed under the Demonstration. Recent actions and statements by HUD seem to confirm this suspicion. HUD's multifamily proposal fails to assign priority to HFA's in restructuring. Furthermore, Secretary Cuomo has questioned publicly the advantages of working with HFA's, suggesting that HFA's will add only an additional layer of bureaucracy to the restructuring process. HUD's officials also have alleged that HFA's are interested only in the restructuring fees. HUD's comments reveal a deeply troubling misunderstanding of the HFA's abilities and motivations. HFA's have many other responsibilities and opportunities that we would like to attend to, but we understand that the preservation of the Section 8 inventory is critical to our States, and we must do everything possible to fill the void caused by HUD's shortcomings.

HUD's sluggish pace, the consistent "hurry up and wait" pattern of activity, and the disparagement of HFA's has not dampened our enthusiasm or our interest in restructuring, however. Despite our disappointment and frustration with HUD's repeated delays, unfulfilled promises, and anti-State bias, HFA's are eager to begin the restructuring process. Three States already have submitted management plans to HUD. This month, HUD approved the plan presented by Ohio, which has the largest portfolio of eligible properties in the Nation, with 3,664 units subject to expiring contracts in fiscal year 1997, as well as the plan presented by Massachusetts. We expect HUD to approve the plan submitted by Virginia soon, and we anticipate several more HFA's will present plans within the next month.

Mr. Chairman, we ask you to recognize in your legislation the qualifications and commitment of the 30 HFA's participating in the Demonstration by directing HUD to allow these agencies to qualify automatically as restructuring agents. This would avoid duplicative processing of HFA's and the additional delays in their restructuring efforts.

In addition to the lessons learned about HUD, the fiscal year 1997 Demonstration has provided early indications that the negative tax consequences resulting from reducing or restructuring the debt on Section 8 properties may discourage property owners from participating in restructuring. Many owners with properties eligible for restructuring this year have been reluctant to step forward, apparently because they do not want to incur the tax penalty. As restructuring agents, HFA's need a full range of financial tools to move restructuring forward. Additional ways of addressing owners' tax concerns may be necessary to ensure maximum participation in this process. We appreciate your efforts to respond to the tax problem with a bifurcated mortgage structure. Questions remain, however, about how the Internal Revenue Service (IRS) will treat the second mortgage in this arrangement, and additional solutions may be needed.

Incentives Should Reward Designees for Additional Cost Savings

Mr. Chairman, HUD's staff assert that your bill will not adequately encourage HFA's to act in the Federal Government's best interest because HFA's have nothing at risk. As I have explained, HFA's have a unique commitment to creating and pre-

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serving decent, safe, and sanitary affordable housing in response to the needs of low-income residents. HFA's do not ask for special financial incentives for producing these outcomes, for HFA's exist to produce these outcomes.

Moreover, HFA's are taking significant risks by choosing to assist the Federal Government by participating in restructuring. These risks stem from the uncertainties associated with working with HUD, the real possibility that HUD's compensation will not cover HFA's costs, and the danger that HFA's will forego valuable opportunities by investing their staff and resources in the restructuring process. HFA's do not require extra compensation for taking on these risks involved in investing their time, resources, and energy in restructuring. We accept these risks as part of our public purpose mission.

Some people also have suggested that financial incentives are necessary to align HFA's interests more closely with the financial interests of the Government. As quasi-public agencies with public accountability, HFA's share the Federal Government's interest in maximizing efficiency and savings to the Government. HFA's will strive to reduce costs to the Federal Government, as we always try to minimize expenses and maximize efficiency. Painfully aware of the limited Federal resources available for affordable housing and the threat Section 8 costs pose to these already scarce funds, HFA's understand the importance of limiting the Federal expense of restructuring solutions.

You have taken the additional step, which we support, of including a shared savings incentive in S. 513, which would provide HFA's with a share of savings resulting from superior restructurings. This incentive is a useful way to provide additional encouragement to HFA's to find savings and minimize Section 8 subsidy costs beyond the level predicted by HUD's baseline model. We recommend that you allow HFA's to receive a 50 percent share of the savings HFA's achieve in excess of HUD's baseline expectations, to fully compensate HFA's for the additional time, resources, and staff we may invest in order to produce savings above and beyond the Federal Government's own expectations. HFA's would use this savings for reinvestment in affordable housing. This type of incentive has a successful precedent in the Financial Adjustment Factor (FAF) agreements that Congress required and HUD entered into with several HFA's in the 1980's. This agreement allows HFA's to retain 50 percent of the savings produced through bond restructurings negotiated as part of the FAF agreement. As in your bill, these savings must be reinvested in affordable housing programs.

Preserve Assisted Housing with Project-Based Section 8 Assistance

Mr. Chairman, we strongly support your legislation's continuation of project-based assistance for the Section 8 portfolio, and we urge you to reject HUD's proposal to convert subsidies to tenant-based assistance for at least 50 percent of the current project-based portfolio. Under HUD's scheme, each time a resident with a voucher vacates a restructured property, a market rate resident may move in and reduce the stock of housing available to lower-income residents. We are deeply concerned about this provision, for it would defeat what HFA's believe is one of the primary performance objectives for restructuring—the preservation of decent, safe, and affordable rental housing for low-income citizens. The Federal Government has invested billions of dollars over the past 20 years in this assisted housing stock. Without continued project-based assistance, this housing will not be preserved as affordable. The Government cannot afford to replace this housing, nor will the private sector produce it.

While tenant-based vouchers may provide a useful option in certain circumstances, they should not be used in place of project-based assistance. In markets with the greatest need for affordable housing, residents cannot use housing certificates or vouchers because of low vacancy rates, rents which are higher than the Section 8 existing Fair Market Rents (FMR), or the lack of available housing. Furthermore, vouchers are not likely to reduce Federal costs significantly or increase resident satisfaction. In short, the cost to the Federal Government of maintaining project-based assistance for the affordable housing stock will be less than the potential cost of losing this housing to conversion or dilapidation and displacing thousands of low-income residents. With the help of State HFA's, restructuring can reduce the expense of preserving assisted housing stock to last into the next century.

Preserve FHA Mortgage Insurance

Mr. Chairman, we commend you for continuing FHA mortgage insurance for Section 8 housing in your bill. This insurance is necessary to guarantee the financial soundness and efficient financing of this housing. We support the use of the FHA Insurance Fund to write down the insured mortgages to levels sustainable at new, reduced rents, and the use of budget-based rents for distressed properties which

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could not operate successfully at market rents even if the FHA-insured debt was written down to zero.

As you know, much of the assisted housing stock is uninsured and, therefore, is ineligible for restructuring under S. 513. Of the 3,000 uninsured projects in HUD's portfolio, 2,700 were financed by HFA's. The HFA's believe that your legislation's provision to renew contracts for these properties at existing rent levels adequately addresses the situation. We also would support language directing HUD to renew contracts on uninsured properties at budget-based levels adequate for continued operation of the properties without threatening existing debt or bond requirements, if HFA's were authorized to make these judgments.

Remove Arbitrary Limits on Rent Levels and Rehabilitation Expenses

Mr. Chairman, your bill allows an HFA to permit up to 20 percent of the units in its jurisdiction to have rent levels not exceeding 120 percent of the local FMR if the housing needs of the residents and the community cannot be adequately addressed by the reduced rents required through a mortgage reduction and rental assistance sufficiency plan. We commend you for recognizing that certain properties located in distressed urban communities or isolated rural areas could not be sustained at market rents. We recommend, however, that you authorize HFA's to waive the limits on these exception rents if necessary in extraordinary circumstances to develop a restructuring plan that meets the needs of a property.

Similarly, we urge you to authorize HFA's to waive the $5,000 per unit limit on the rehabilitation expenses if we judge it necessary to meet a property's long-term capital needs. Although research has shown that the average rehabilitation costs around $5,000 per unit, variations in costs should be permitted where necessary to allow restructuring to address the specific rehabilitation needs of individual properties. Inadequately addressing a property's capital needs now may lead to more expensive structural problems later.

Thank you for this opportunity to present our views.

PREPARED STATEMENT OF JOHN J. KOELEMIJ

PAST PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS

JUNE 17, 1997

Mr. Chairman, Senator Kerry, and Members of the Subcommittee: My name is John Koelemij and I am a home builder from Tallahassee, Florida and Past President of the 190,000 member firms of the National Association of Home Builders (NAHB). On behalf of the NAHB, I thank you, Mr. Chairman, as well as other key Members of the Subcommittee and of the full Banking Committee, for your leadership and perseverance in continuing to strive in order to achieve both a responsible as well as equitable solution to the task before you with respect to the expiring project-based Section 8 rental assistance contracts. I also want to publicly thank and acknowledge our appreciation for the Subcommittee's professional staff, both Republican and Democratic, for their dedication, accessibility, and their in-depth knowledge of housing programs. They serve you well.

Further, I thank you for the opportunity to appear here today to comment on the "Multifamily Assisted Housing Reform and Affordability Act of 1997," S. 513. As the Chairman and the Members of this Subcommittee know all too well, project-based Section 8 rental assistance contracts, have begun to expire. Their numbers are estimated to be 1.3 million units. Of this universe, approximately 900,000 are in structures with mortgages insured by the Federal Housing Administration (FHA). An additional 50,000 units, in about 1,700 projects, are financed by a direct loan from the Rural Housing Service at the Department of Agriculture. Other units are in projects financed by bonds through various State housing finance agencies.

While some of these rental assistance contracts are co-terminus with the terms of the mortgage, most are not. Consequently, if the Section 8 rental assistance contracts are not renewed, these projects are at serious risk of default and foreclosure. The practical effect of Congress taking no action exposes a wide variety of stakeholders to very serious consequences. These stakeholders include: the FHA Insurance Fund, the Department of Agriculture, the Department of the Treasury, and HUD; State bonding agencies; private lenders; a vast number of communities and neighborhoods; owners and most importantly, the residents the program is intended to serve.

Most owners of this valuable housing stock are dedicated to providing good housing that is decent, safe, sanitary, and affordable. Residents depend on this rental housing for shelter and security. In many neighborhoods, this housing serves as an

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anchor for the community. These are very sound reasons, indeed, Mr. Chairman for taking actions that will preserve this housing in the affordable housing stock, minimize the risk of loss and likelihood of increased liabilities for responsible owners, minimize the displacement and the uncertainty for current residents, and protect the physical asset that this housing provides.

NAHB believes that Section 8 portfolio re-engineering should contain certain elements essential to providing a responsible and equitable solution. First, the formula should be clear, workable, and flexible, as a "on one size fits all" system simply will not work. S. 513 contains this essential element. The bill provides for new, lower rents for projects based on rents for comparable unassisted properties in the area, or, if no such measure is available, 90 percent of the HUD Fair Market Rent (FMR). Existing mortgages would be restructured to provide a reduced new, or modified, first mortgage with lower debt service, which along with operating costs, can be covered by the lower rents. Funds to pay the difference between the old mortgage and the new mortgage would come from the FHA Insurance Fund. In order to avoid certain adverse tax consequences arising from the reduction of the first mortgage, funds provided by FHA to roduce the first mortgage would be repaid by the owner through a second mortgage. The lower rents would result in lower rental subsidies from HUD.

Second, if the debt is to be restructured, the restructuring entity should be a public body. Section 8 project-based rental assistance involves the use of public funds. Only public bodies have the accountability necessary for balancing social policy with the fiscal policy in a responsible manner, while being accountable to taxpayers. S. 513 embraces this element by maintaining an active role by public entities for any reform of the Section 8 portfolio; namely the local and State Housing Finance Agencies (HFA's). NAHB strongly supports this approach.

We recognize that not all public housing finance agencies possess the ability to restructure the debt on properties that exceed market value, nor to determine the actual market value. HFA's should, nonetheless, remain in control of the process, while contracting out certain functions to FHA-approved mortgage lenders and other entities that are qualified to deliver a responsible and workable approach. Re-engineering, or financial restructuring, on over-market properties should focus not only on roducing the cost to the Government, but it should also focus on protecting the physical asset along with responsible owners, managers, and the hundreds of thousands of elderly, disabled, and other low-income families. S. 513 achieves this goal.

Third, the rental assistance should remain as project-based. Empowering residents by providing alternative housing choices is a commendable concept and can be a useful tool. However, in this instance, we are in most cases misleading the public, if not ourselves, for there often exists no alternative housing. Instead, the goal should be one of adequate protection for the joint needs of current residents, the fiscal viability of responsibly-owned and well-managed housing projects, the overall cost to taxpayers, and the continuation of needed affordable housing that serves as an important resource for the community. S. 513 embraces this element.

Continuation of project-based assistance provides the highest level of protection for current residents. For the elderly and disabled, tenant-based assistance does not offer choice, but rather uncertainty. This is particularly true in tight housing markets in major urban areas as well as in rural areas. "Vouchering-out" project-based rental assistance does, however, pose an increased risk to the continued financial viability of an affordable housing resource. "Vouchering out" also places residents at greater risk that the Government's commitment to providing rental assistance can be reduced in overall numbers with greater ease.

Further, NAHB is deeply concerned with the Administration's proposal, which provides project-based assistance for the elderly and disabled, but not for housing occupied by families with children. NAHB believes that it is important to preserve affordable housing for the elderly and the disabled, as well as housing occupied by low- and moderate-income families.

The fourth element is maintenance of FHA insurance. NAHB believes that FHA insurance should remain in place on those projects that have their mortgage debt restructured. Without FHA insurance, many otherwise good and fiscally-sound housing projects will be unable to obtain long-term financing at reasonable interest rates. S. 513 embraces this element. The combination of project-based assistance, which is mandatory, combined with the presence of FHA multifamily mortgage insurance on one-year renewals of the rental assistance, increases the likelihood that future renewals will be forthcoming.

The Administration's proposal potentially would subject literally hundreds of thousands of residents to displacement as long-term pressures on balancing the budget prevail over the more limited resistance to renewing tenant-based assistance contracts. As existing residents either move or cease to need assistance, the overall

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supply can be more easily reduced by failure to re-issue the certificates or vouchers. Further, in certain markets, projects will quickly become destabilized as low-income residents receiving rental assistance move, or exit the program, and no new assistance is provided for additional families. If market rate renters cannot be located or attracted to the project, then they will go into default and foreclosure.

Fifth, responsible owners of this housing should be provided adequate protection from the likelihood of unnecessary tax consequences as a result of debt restructuring. If the Federal Government takes actions to restructure the debt, it has the responsibility to protect those stakeholders who would otherwise be penalized, albeit unintentionally, as the result of these actions. While not containing a tax solution through the Internal Revenue Code, S. 513 turns that portion of the original debt that is above the market value into a second mortgage. While this approach is far from perfect, it is preferable to the tax consequences that would occur for many owners without it. The Administration's proposal would increase an owners' tax liability beyond that which currently exists without debt restructuring or sale of the property. It creates a preference for sale to certain purchasers, by providing favorable tax treatment to sales to nonprofits, but no tax relief for sales to for-profits, thereby reducing the overall value of the properties. Also, the provision calls for owners to relinquish the step up in basis at death. This would result in a major change in what has been an integral part of tax law for decades.

Sixth, restructured rents should be based on market comparables, not on HUD's Fair Market Rents (FMR's), which often do not reflect the current market. Further, rents can, and often do, vary widely throughout a metropolitan area leaving the FMR's far too low in more costly sections of an area, while excessively high in other neighborhoods.

Seventh, restructuring should not abrogate an owner's right to prepay the existing mortgage. S. 513 embraces this element. Owners have the option simply to prepay the current mortgage without participating in the program. The Administration's proposal, on the other hand, does not allow property owners a clear right to prepay their mortgage obligation and seek other uses for their properties. It also would require owners receiving many types of housing assistance to lease a set amount of units to holders of tenant-based assistance, abrogating contract rights of the owners.

With respect to the Section 515 rural direct loan program administered by the Rural Housing Service (RHS) at the Department of Agriculture, NAHB supports the Chairman's decision to renew these Section 8 assistance contracts at current rents. Additionally, we would support any efforts by this Subcommittee to ensure that when these Section 8 contracts do expire, that they are renewed as Section 8 contracts, as opposed to transferring them to the RHS Section 521 rental assistance program until any rural restructuring proposals are fully developed.

When I appeared before this Subcommittee a year ago, I offered our support for last year's version of S. 513. This year, I again offer our support for S. 513. It embraces not only the basic principles for responsible housing policy, but also a clear, concise, and workable formula that protects all stakeholders in the program.

We remain concerned, however, over the following three issues:

First, we strongly agree with the authors of S. 513 that the restructuring entities must be public organizations. And, most of the provisions in this legislation direct the restructuring to public entities. Section 103(b)(3)(B), however, provides HUD with a "back door" to contract with nonpublic entities, including Wall Street investment bankers to conduct the restructuring. NAHB believes that this "back door" approach, while admittedly a narrow opening, will, nonetheless, allow HUD to involve firms with motivations to take these properties from their current owners and displace their low- and moderate-income residents. NAHB urges that this provision be stricken.

Second, NAHB believes that the bill should contain workable "exception rent" provisions. NAHB is aware of many projects, particular in New York City, as well as many rural areas, where comparable properties do not exist, and where operating costs are high in comparison to HUD's FMR's. A substantial portion of these properties serve seniors who need special services and facilities. It is appropriate to shift to budget-based rents as "exception rents" when the formula cap will not support operating costs without debt service for these properties. However, the technique for establishing a higher exception rent cap (120 percent of the FMR in S. 513) and annual limits for use of exception rents (20 percent of expiring units) is not a proper approach for controlling operating costs and simply will result in the removal of hundreds of good projects from the affordable housing stock. A HUD commissioned study by Ernst & Young indicates that market rents would not cover operating expenses in 1,100 of the 8,400 projects in the privately-owned FHA-insured HUD-assisted portfolio. Many of these worthwhile projects, particularly the elevator structures for seniors in rural areas, would have to be demolished because existing

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residential market rents will not support operating costs and these buildings cannot be converted to other uses.

NAHB urges that these limitations be removed from S. 513. In their place, NAHB supports language to be added to Section 104(g)(2), allowing Participating Administrative Entities (PAE's) to exceed restructuring rent limits and utilize budget-based rent levels for "exception projects" where the PAE determines that the housing needs of the tenants and the community cannot be addressed adequately through restructuring.

Third, as was discussed above, many projects are located in communities where comparable properties do not exist, particularly in rural areas. Comparable properties do exist, however in other communities of similar size and characteristics and can be utilized by expanding the definition of "comparable properties" to allow State certified appraisers, pursuant to the standards of the Uniform Standards of Professional Appraisal Practice, to locate and use actual comparables.

Thank you for considering our comments on this legislation of vital importance to the industry.

I would be happy to respond to any questions that Members may have.

PREPARED STATEMENT OF ALBERT A. WALSH, ESQ.

BOARD MEMBER, NEW YORK HOUSING CONFERENCE

JUNE 17, 1997

Mr. Chairman, thank you for the opportunity of appearing before your Subcommittee today to express the views of the New York Housing Conference (NYHC) on this most important piece of legislation. The NYHC, which was founded in 1973 and became an independent affiliate of the National Housing Conference in 1975, is composed of representatives of for-profit and nonprofit developers, owners and managers of low- and moderate-income housing, financial institutions, housing professionals, community leaders, and affordable housing advocates.

As you know, Mr. Chairman, many thousands of affordable housing developments throughout the country, including more than 600 developments in the city of New York, were financed by HUD using a combination of FHA insurance and project-based Section 8 subsidies. For the most part, at least in New York, these developments were modestly designed and have been well maintained through the years and represent an irreplaceable housing resource for low-income families. However, the Section 8 program contained a major flaw which has now placed all of these developments at risk; the Section 8 contracts were not co-terminus with the term of the FHA-insured mortgage, thus placing the FHA Insurance Fund, the economic viability of the developments and the very homes of hundreds of thousands of tenants at risk at the end of the Section 8 contract term. In addition, in many cases the cumulative effect of automatic Annual Adjustment Factors (AAF's), applied over the years, caused developments to have subsidized rents far above the amounts needed for debt service, operating expenses, required reserves, and a reasonable rate of return, thus costing the Federal Government more subsidy than necessary to maintain the developments as decent and affordable rental housing.

Commencing early in 1996, I was privileged to be one of a group of housing professionals, from both the public and private sectors, which you consulted in your effort to find a solution to both the policy and budgetary implications of the Section 8 contract renewal problem. You and your colleagues are to be commended, Mr. Chairman, for the solutions now embodied in S. 513. Given the agreement of the Congress and the Administration to balance the Federal budget by the year 2002, the staggering dimensions of projected Section 8 contract renewal costs and the potentially devastating effects of nonrenewal on residents and communities, the bill constitutes an absolutely essential first step in resolving the HUD Section 8 funding crisis. It provides a comprehensive structure and mechanisms through which the spiraling costs of Section 8 assistance can be abated and a majority of assisted developments preserved within the parameters of the bipartisan budget agreement.

The essence and, if you will, the genius of S. 513 is the simultaneous restructuring of the FHA-insured mortgage and the Section 8 contract at the time of contract renewal. Through a Mortgage Restructuring and Rental Sufficiency Plan (Plan) initiated by the owner and implemented by a Participating Administrative Entity (PAE) pursuant to a contractual agreement with HUD, new lower rents for the development will be set based on the rents of comparable unassisted rental housing in the area. If no such comparables are available, 90 percent of the HUD's Fair Market Rents (FMR's) for the area will be used as a surrogate. The project-based Sec-

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tion 8 contract will be renewed, at the reduced rent levels, on a year-to-year basis, with either an FMR adjustment or a budget-based operating cost adjustment on each annual renewal, and the FHA mortgage will be written down to a level where debt service and operating expenses can be met by the lower rents, with a corresponding payment of claim by the FHA Insurance Fund. The Plan will also require the owner or purchaser of the development to maintain use and affordability restrictions, as determined by the PAE, for 20 years.

Coming from the city of New York, where both the development and operating costs of housing are high and the HUD's FMR's are relatively low (because they are based in large part on recent moves into rent regulated housing), we are particularly appreciative of the provisions of the bill allowing the PAE to set budget-based exception rents, up to 120 percent of FMR, for up to 20 percent of the rents in its geographic jurisdiction, and the further provision allowing HUD to increase the 20 percent limitation upon a finding of special need.

Most important, the bill recognizes that the continued availability of FHA insurance, adjusted to market levels, and project-based Section 8 assistance, at levels sufficient to service the restructured debt and legitimate operating expenses, are essential to the continued existence of this absolutely irreplaceable supply of affordable housing. While the Section 8 contract must be renewed annually, the continued presence of FHA insurance makes it likely that such renewals will occur. Replacing project-based Section 8 contracts with tenant-based assistance would, of course, provide even less security for the mortgagee, to say nothing of the myraid tenant problems inherent in any attempt to "voucher out" the current project-based contracts.

The New York Housing Conference also strongly supports the concept of local or State housing finance agencies as the primary restructuring entities. By definition, such entities act in the public interest and are publicly accountable. With two strong and experienced agencies, the New York State Housing Finance Agency (HFA) and the New York City Housing Development Corporation (HDC) already servicing large urban mortgage portfolios in New York, there does not seem any need for an "Alternative Administrator." While the "preference" language of § 103(a)(4) is somewhat troubling, we are confident that, as in the past, HFA and HDC will divide the work in an appropriate fashion. Certainly, each such agency should have the right to act as the PAE with respect to any development where it is the mortgagee.

Since the cancellation of all or a portion of a mortgage debt is generally treated as taxable ordinary income under the Internal Revenue Code (Tax Code), in order to encourage owners to participate in the restructuring process the bill bifurcates the existing mortgage into two obligations; a new FHA-insured first mortgage in an amount that can be supported by the reduced rents and a soft second mortgage held by the PAE as agent for HUD. Because we strongly believe that for-profit owners must have at least some potential of a cash return if they are to be held responsible for maintaining their developments in compliance with housing quality standards, the New York Housing Conference recommends that 25 percent of any cash flow in excess of debt service on the insured first mortgage, operating expenses of the development, and required reserves be made available to the owner. The remaining 75 percent should be applied to the payment, first of accrued interest and then to principal, on the second mortgage.

In the absence of an express amendment to the Tax Code, which I am told is extremely unlikely, from both a jurisdictional and scheduling point of view, there can be no guarantee that such a bifurcation will avoid adverse tax consequences to the owner. However, a very similar bifurcated structure was used, with the blessing of the Internal Revenue Service, in connection with a series of Section 223(f) refinancings of Mitchell-Lama projects in New York in the mid–1970's. Admittedly, the tax law has changed since then (i.e., the OID and "material modification" rules adopted in the mid–1980's) but we would urge that, where the reduction in the amount of Federally-insured debt is directly proportionate to the reduction in Federal subsidy supporting that debt, such debt reduction should not be considered a "cancellation of indebtedness" nor should the terms of the soft second mortgage be construed as an "original issue discount" for Federal income tax purposes. If it is not possible to amend the Tax Code to make this clear, then we urge that precatory language to this effect be included in the report accompanying this legislation.

We are aware that the Administration's Housing Opportunity Act of 1997 (H.R. 1433) would amend the Tax Cede to allow deferral and amortization of tax liabilities for up to 10 years for owners whose debt is restructured by more than 30 percent

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and less than 75 percent of the unpaid principal balance.[1] Frankly, we doubt that the opportunity to pay taxes, for 10 years, on phantom income resulting from a debt and subsidy restructuring dssigned to save Federal dollars will incentivize many owners. More fundamentally, however, the Administration's bill completely fails to recognize the owners' lack of economic return since enactment of the Tax Reform Act of 1986. In most cases the tax benefits that the owners initially expected to receive have been suspended for the past 10 years. To be effective, any legislation intended to encourage owners to participate in a restructuring program must make some attempt to compensate the owners for the "passive losses" that they have not been able to use.

Instead, the Administration's bill actually penalizes owners who participate. It not only takes away the "step-up in basis on death" that has been in the law for many years but also actually places owners in a worse economic position than the status quo. If past inequities cannot be addressed, any amendment of the Tax Code should at least leave owners in the same position they would have been in had they not participated in the program; they should pay no more and no less tax over the remaining term of the development's underlying mortgage than they would have if the mortgage had not been restructured. By any fair measure, this approach should be revenue neutral to the Federal Government. In addition, owners participating in a restructuring should be permitted to use their suspended losses to offset any tax liability resulting from the restructuring.

S. 513 recognizes that some of the developments whose mortgages are to be restructured suffer from deferred maintenance due to a lack of positive cash flow under the present mortgage structure. The bill allows up to $5,000 per unit to be included in the restructuring budget to correct such conditions, provided that the owner contributes at least 25 percent of the cost of the work done. The New York Housing Conference would hope that this 25 percent contribution requirement could be waived for nonprofits with good track records. Also, where more significant rehabilitation is necessary, the bill should authorize payment out of available project reserves or residual receipts, or financing by a further write down of the FHA-insured mortgage, or restructuring of Section 236 Interest Reduction Payments.

The New York Housing Conference has not yet developed a final position on Title II of the bill. While effective enforcement of the laws and regulations designed to prevent fraud and abuse in HUD-assisted programs is clearly desirable, and new enforcement tools and sanctions may be necessary, it is not at all clear that HUD, at least until very recently, has made effective use of the enforcement tools and sanctions that it now possesses or that Title II contains (directly or incorporated by reference) all of the due process safeguards that we would want to see in criminal or civil penalty statute. It is our experience that enforcement mechanisms that appear to be strong, but lack due process safeguards, such as written notice, opportunity to cure, materiality, judicial review, etc., may in the end prove to be unenforceable.

Mr. Chairman and Members of the Subcommittee, I want to thank you again for the opportunity to appear before you today and I want to assure you of the continued cooperation and support of the New York Housing Conference in moving this important legislation forward as expeditiously as possible. We simply cannot afford to let another year go by with the critical problem of expiring project-based Section 8 contracts unresolved.

PREPARED STATEMENT OF MARY YEATON

BOARD MEMBER, NATIONAL ALLIANCE OF HUD TENANTS

JUNE 17, 1997

Mr. Chairman, my name is Mary Yeaton. I live at Charlesbank Apartments in Boston, Massachusetts. I am a Board Membor of the National Alliance of HUD Tenants (NAHT). On behalf of NAHT, I am pleased to submit these comments to the Subcommittee in support of S. 513.

NAHT appreciates the invitation to testify before Congress on legislation which affects our homes. Founded in 1992, NAHT is the only national membership organization representing the 2.1 million lower-income families served by HUD's multifamily portfolio. Our membership—including tenant groups and area-wide tenant

[1] A quick check of New York developments in the HUD portfolio would appear to indicate that more than half would be ineligible for any deferral under this standard because they will require a mortgage reduction of 75 percent or more.

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coalitions in 24 States—has led the grass-roots fight against proposals to voucherize and deregulate HUD's multifamily housing and for alternatives such as S. 513 that would save our homes instead.

NAHT Support for S. 513

NAHT supports the Subcommittee's approach to Section 8 renewals and mortgage restructuring as outlined in S. 513. The bill represents a thoughtful, workable framework to preserve assisted housing in a manner largely consistent with NAHT's principles. In particular, the requirement in S. 513 for owners to renew project-based Section 8 contracts for at least 20 years in exchange for debt restructuring and new HUD mortgage insurance would preserve affordable housing and minimize the risk of tenant displacement. S. 513 also would allow HUD to delegate restructuring to State or local governments, but not to for-profit companies. This would help avoid a Resolution Trust Corporation (RTC)-type "fire sale" of HUD housing and ensure that the public interest is protected. By contrast, HUD's approach in H.R. 1433 does not meet these tests.

Tenants' objections to voucherization are by now well-known, and are summarized in our written testimony. NAHT believes that deregulation and "voucherization" can and should be separated from plans to financially restructure HUD's project-based Section 8 housing, an otherwise worthy goal.

Improvements to S. 513

While a good start, S. 513 could be improved in several areas. Briefly, the NAHT believes that the best provisions of the HUD "2020" bill—stronger enforcement provisions; tax breaks to owners who sell to tenant or nonprofit groups; and long-term use restrictions in the event that Section 8 funds are not available—should be added onto S. 513. We also urge the Subcommittee to reduce long-term costs even further by adopting NAHT's proposal for "Balanced Budget Rents" along with a one-time use of HUD's Mortgage Insurance Fund for repairs. In addition, the $5,000 rehab cap in S. 513 serves no purpose and should be removed.

Restore One-Year Notice Provision

One issue, however, deserves special mention today. Last week, Congress voted to reduce the required notice period to tenants of expiration of recently renewed Section 8 contracts from 1 year to 6 months. NAHT certainly agrees with proponents of this change that HUD's current notice letter is poorly worded and confusing to tenants. However, to respond by withholding information from tenants about their true risk situation until it may be too late is a mistaken, if well-intentioned approach. As an alternative, HUD has agreed to publish next week, almost verbatim, a new letter to tenants prepared by NAHT and its affiliates which should obviate the need for a legislative response.

We urge the Subcommittee to restore the one-year notice requirement or, at least, to clarify in Committee Report language that the new 6 months notice is a minimum requirement which HUD can exceed by regulation.

Make Tenants HUD's "Eyes and Ears" in Enforcement

Perhaps the least developed concepts in S. 513 have to do with the role of tenants in enforcement of HUD's standards in properties with Section 8 contract renewals and/or restructured mortgages. HUD is currently woefully understaffed to carry out its oversight obligations. NAHT believes there is an alternative which can preserve and improve the assisted stock at virtually no cost to the Government: *Let tenants assist HUD in its oversight of HUD housing.*

Tenants are the "customers" with the greatest stake in the quality maintenance of HUD's multifamily portfolio; we are the people who must live, everyday, with the consequences of HUD's oversight of our homes. Potentially, tenants make up millions of unpaid volunteers with the interest and on-site knowledge to maintain affordable housing and ensure that owners keep up their obligations.

Tenants across the country, working through the NAHT and its affiliates, have already initiated a revolutionary volunteer effort to serve as the "Eyes and Ears" of HUD. In New York and New Jersey, tenants who are members of NAHT have been meeting on a quarterly basis for over 3 years with HUD's multifamily housing staff to identify problems and work out solutions. These meetings have resulted in dramatic improvements in people's living conditions, HUD's enforcement response, and agency morale, at virtually no cost to other taxpayers.

Some people talk about "Reinventing Government." Through NAHT, and with the cooperation of HUD, tenants are actually doing it—from the ground up.

With S. 513, Congress has a unique opportunity to join this exciting effort. Since 1992, NAHT has proposed several specific measures to "Make Tenants HUD's 'Eyes and Ears' in Enforcement." Sevoral of these measures came very close to adoption

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by Congress in September 1994. As a starting point, the Subcommittee should incorporate these provisions in S. 513. NAHT's legislative suggestions to enhance tenants' volunteer partnership with HUD are described in our written testimony. In brief, Congress could:

1. *Establish a Tenant's Right to Repair and Be Reimbursed By HUD Where HUD Withholds Section 8 Payment (as passed by the House in 1994).*

2. *Establish a Right of Section 8 Tenants to Withhold Rent and Pay into an Escrow Fund for Repairs (as stated in the bipartisan Staff Draft of the Senate Floor Manager's Amendment, September 19, 1994).* This provision should include a mandatory inspection and enforcement program as well.

3. *Establish tenants and their organizations as third-party beneficiaries to HUD's Section 8 and mortgage contracts with the power to sue for enforcement.* Congress can mandate that language to this effect is added upon contract renewal.

4. *Allow tenant-based consortiums to participate as subcontractors to HUD and/or Participating Administrative Entities (PAE's) to assist in oversight of the assisted housing stock.*

5. *Clarify that PAE's and qualified nonprofit subcontractors may assess HUD's sanctions on nonperforming owners and managers.*

6. *Allow tenants and tenant-based organizations to sue for enforcement under the Federal False Claims Act.* Tenants and tenant-based organizations, including the enforcement consortiums described above, should be allowed to use this innovative statute to collect monetary damages in cases where properties are mismanaged.

7. *Provide for technical assistance funds for tenant organizations to participate fully in project restructuring and oversight.* NAHT requests that the Subcommittee provide at least $20 million annually for tenant outreach and training to ensure that residents are able to participate as full partners with HUD and PAE's in the mortgage restructuring and project oversight process. Section 104(f)(3) should be amended to clarify HUD's flexibility to allocate technical assistance funds directly to tenant-based providers to conduct extensive outreach, training, and support "Eyes and Ears" meetings in their areas, as well as more intensive "project-specific" technical assistance in the restructuring and/or ownership transfer of specific buildings.

Conclusion

With S. 513, the Subcommittee has a historic opportunity to preserve housing, prevent displacement, save long-term budget authority, and empower residents to help oversee our homes. In particular, by empowering citizen volunteers to be partners with HUD in enforcement, Congress will augment the Department's limited staff to safeguard its investment in Section 8 housing. By enlisting residents as HUD's "eyes and ears" to arrest problems before they require more expensive solutions, Congress will save HUD's money otherwise needed for more extensive repairs in the future. Accordingly, we urge that language accomplishing these objectives be added to the proposed Senate bill.

Thank you for the opportunity to make tenant voices heard in this process.

PREPARED STATEMENT OF JAMES R. GROW

ATTORNEY, NATIONAL HOUSING LAW PROJECT

JUNE 17, 1997

Mr. Chairman, the National Housing Law Project appreciates this opportunity to contribute to this Subcommittee's consideration of comprehensive legislation to restructure the Section 8 project-based portfolio. The views presented here reflect the work of the Project over the almost three decades since its creation in 1968. During that time we have served as a technical support center on housing and community development matters for lawyers and other housing advocates working with tenant leaders and community groups nationwide seeking housing justice for low-income Americans. Our support role has included legal research, advice and co-counsel regarding litigation matters, legislative and administrative advocacy, publication of our *Housing Law Bulletin* and housing law manuals, and training and technical assistance. Working with these local housing advocates, dealing with the day-to-day problems and opportunities presented by implementation of Federal housing laws and programs, has developed the views we express today.

After providing some brief background considerations for shaping restructuring policy, our statement covers the major and considerable strengths of S. 513, before reviewing some remaining concerns. We understand that a revised discussion draft of the bill will be released shortly, and thus we request leave to submit a separate

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memorandum addressing technical points raised by that draft. The general preservation approach taken by S. 513 represents the best proposal advanced over the past 2 years to address these important and complex issues. We commend the leadership of the Chairman and the extensive efforts of your Subcommittee staff in developing this bill. Although we would prefer a bill that explicitly assures protection of Section 8 assistance for the same number of assisted families and the same occupancy profile, rather than leaving this fundamental question to the annual appropriations process, passage of S. 513 would move the process forward in the right direction.

1. Background for Developing Sound Restructuring Policies

THE BUDGET CHALLENGE. An essential objective of any Section 8 restructuring program is to address the fiscal problems facing the Section 8 budget over the next decade. Saving discretionary budget authority and outlays by reducing Section 8 contract rents is thus the main focus of S. 513 and other proposals. Because of the peculiarities of Federal budget accounting, this goal is especially important as the Federal Government moves toward a balanced budget. By reducing subsidies on those properties receiving higher subsidies to market levels, S. 513 achieves important discretionary savings that will help to roduce outlays.

A second major fiscal challenge is the unique Section 8 budget problem presented by growing numbers of expiring contracts. The recent Balanced Budget Agreement and the budget resolutions reportedly include explicit designation of full Section 8 renewal funding. For the restructuring policy of S. 513 to succeed, Congress must actually deliver this funding for Section 8 through the appropriations process every year, and provide the needed outlays for the program and its current residents.

THE POLICY CHALLENGES. Often obscured in this extraordinary fiscal challenge is the central question surrounding the future of this enormous project-based Section 8 housing stock with expiring contracts and the residents and communities that need it.

WHO IS SERVED. The inventory consists of about 1.3 million units, financed in a variety of ways and subsidized under various Section 8 subprograms (e.g., New Construction, Substantial Rehabilitation, Moderate Rehabilitation, Loan Management Set-Aside, etc.). All units share the common feature of project-based Section 8 funding that eventually expires. The stock serves residents with very, very low incomes, averaging around $8,000 per family annually. Tenant families pay an average of about $180 monthly toward the rent, with the balance covered by Section 8 assistance. These tenants cannot afford even operating costs of private market rental housing. The availability of Section 8 as an operating subsidy is critical for meeting their needs, even if assisted properties had no debt burdens. About half of these families are people of color, and about half are elderly or people with disabilities.

GROWING LOW-INCOME HOUSING NEEDS. In developing a comprehensive restructuring policy for this portfolio, Congress must also consider the general housing picture facing Americans with low incomes. Because incomes of people near or below the poverty line are outpaced by growing housing costs, worst case housing needs, concentrated among unassisted families and individuals with very low incomes, are growing. Now, these housing needs are growing faster than the society's commitment to meet them. This will increasingly be the case as rental housing markets of moderately-priced units around the country continue to tighten, as excess capacity produced during the early 1980's—fueled by since-repealed real estate tax shelter subsidies—is increasingly absorbed.

Thus, preservation of the levels of housing assistance and inventory currently devoted to addressing worst case needs is absolutely essential. Any significant reduction in outlays for Section 8 that reduces the number of units or families assisted, or shifts the use of these resources to families with higher incomes, invariably means that we will fall further behind in meeting worst case housing needs. The inevitable consequence will be more housing deprivation, manifested as overcrowding in generally substandard housing or homelessness. The resulting economic and social costs are unacceptable.

Restructuring policy should incorporate the lessons of the past in developing a vision for the future. Using the event of contract expiration only to pursue a narrow fiscal goal of restructuring rents, subsidies, and debt burdens would be incredibly shortsighted, deferring for but a few years the need to face any other important problems. We must also control costs as much as possible by adopting rent increase methods that provide adequate income for cost increases and involving residents to make sure that project funds are being properly spent.

Our experience over the past 20 years demonstrates that we must use public investments in housing more wisely, to produce quality living environments and neighborhoods for assisted-residents. The public investment should be linked to quality performance standards and long-term preservation of the housing resource,

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to avoid the instability and cost of both market conversions when conditions permit more profitable uses and public bail outs when they do not. A redesigned Section 8 program should also build stronger relationships and accountability between residents, housing providers, regulaters and surrounding communities, through both positive incentives and requirements of participation and consultation. Finally, housing should be integrated with job training and employment opportunities, and supportive social services such as child care and transportation.

Restructuring policy should consider these broader goals. If we cannot address all of these goals now in S. 513, we must at least assure that we are taking steps in the right direction. America simply cannot afford to bypass this unique opportunity to use the event of contract expiration to improve the housing delivery system, to channeling any additional benefits and resources, to ensure more accountable and cost-effective operations, and to produce permanent investments in our affordable housing supply.

Specifically, any comprehensive restructuring program should:

- reduce unnecessary discretionary spending;
- protect tenants;
- preserve the housing stock for people of similar need;
- be administered by qualified and responsive public entities that can resolve the myriad of often conflicting fiscal, policy, and social goals presented;
- involve tenants in all major aspects of restructuring *and* ongoing project operations, assuring that providers, managers, and administrators are more responsive to tenants' needs;
- encourage transfers to ownership responsive and dedicated to tenant and community needs for affordable housing;
- prevent unwarranted private benefit from public investments;
- continue project-based assistance except in extraordinary circumstances to preserve the quality developments that offer guaranteed access for Section 8 eligible families;
- screen out bad owners but not basically sound properties, which should be transferred to responsive community-based ownership; and
- require rehabilitation planning and resources adequate to ensure the long-term viability of these properties as affordable housing.

At stake in this restructuring process is the control and future operation of at least 500,000 "over-subsidized" HUD-insured units, many of which have little or no true equity beyond their current debt burdens. We must bear in mind that the Section 8 subsidies provided over the next 10 to 20 years will contribute significantly to the retirement of principal obligations on the reduced first mortgages, which inures to the benefit of the owner. Sound public investment strategies to retire capital costs, if linked to transfers into the restricted nonprofit or public ownership sector or to long-term use restrictions, could roduce eventual renewal costs to those required for operating and recapitalization expenses.

By virtue of the impending expiration of the subsidy contract, the Federal Government now effectively controls what happens to these properties. The terms of Congress' restructuring program, and the mix of benefits provided and burdens imposed will determine the responsiveness of using this stock as a future tool to meet still-expanding affordable housing needs among very low-income families.

The benefits of restructuring for owners could include subsidy levels, debt restructuring or forgiveness, rehabilitation resources, and even tax relief. The burdens could include long-term use and affordability restrictions, second mortgage repayment obligations, transfer rights or preferences for tenant-endorsed and community-based purchasers. Defining this package provides the fundamental challenge before us, a tremendous, once-in-a-lifetime opportunity to construct a new and improved system of performance accountability.

2. Positive Components of S. 513

Evaluated under these criteria, the current version of S. 513 contains a very solid foundation and represents a giant step in the right direction. Instead of proposing radical and untested large-scale substitutions of vouchers, S. 513 generally seeks to use restructuring to reduce Section 8 discretionary spending while preserving the current project-based program. It would also make some modest improvements by getting rid of some bad owners, fostering tenant participations and providing some new regulatory enforcement tools. S. 513 contains the following vital components:

- *Reduction of Section 5 demands on scarce discretionary budget authority and outlays* through rent, subsidy, and debt reduction.

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- *Preservation of project-based assistance.* Voucher substitutions would be limited to certain higher-cost troubled properties or owner opt-outs where renewal rents would not cover true market values.
- *Retention of the public investment in restructuring* for the public interest. S. 513 would accomplish this through the form of FHA insurance for the remaining first loan, and through the combination of the deferred second mortgage (instead of debt forgiveness) and use restrictions that, for the life of the second mortgage, require the owner to accept Section 8 subsidies offered by the Government and maintain the restructured rent levels (§ 105). This essential component linking an often significant deferred second mortgage obligation to strong use restrictions represents a major improvement over last year's version of the bill (S. 2042, 1996). (However, to preserve affordability, S. 513 should also prohibit prepayment of this second note, and require restructured owners to maintain cost-based rents after restructuring.)
- *Recognition of the essentially public purpose role* for the new administrator. PAE's that are State or local housing agencies, or HUD, would execute these important duties.
- *Establishment of a specific planning process with resident and community participation and funding* for technical assistance to implement it (§ 104(f)). S. 513's requirements that residents and communities must be allowed to participate by commenting on both the administrator's plan and on individual project plans, and authorizing resources for technical assistance and capacity building are particularly important. S. 513 specifies the precedures that HUD must include, such as notice, access to information, and comment and meeting rights.
- *Recognition of the need for rehabilitation planning and for significant Federal resources and owner contributions* (§ 107(a)(7)).
- *Encouraging better performance* through screening out bad owners and by making improvements to the post-restructuring enforcement structure (Title II). We strongly support Title II's strengthening of tools to enforce program rules against owners, such as expanded equity skimming prohibitions and extending double damages remedies to all HUD-insured, risk-sharing and Section 202 programs, and broadening civil money penalty liability to include general partners, officers and directors, and certain managing agents, and making violation of Section 8 contracts an offense subject to the penalties.

In contrast to other proposals under discussion, these provisions of S. 513 would improve rather than abandon Section 8 housing policy. Of special importance are provisions reportedly contained in the revised draft to maintain use restrictions including acceptance of Section 8 as long as the second mortgage is outstanding, to permit the PAE to forgive the second note in the case of a sale to a nonprofit or public agency, and to ensure that project-based assistance will continue in the case of the approved transfer of a disqualified owner's property. A few of these provisions require greater specificity, as mentioned *infra.*

3. Areas Requiring Further Improvement

However, the Project believes that S. 513 inadequately addresses other key components of a compreliensive restructuring program. *The most important overall question is whether S. 513 ensures quality and responsive performance by owners that restructure.*

Specific concerns include the following:

NO TAX SOLUTION/INCENTIVES. There is no lasting solution to the tax problems caused owners by restructuring, so owners may only reluctantly participate or may defer participation until the eve of expiration, depriving the Government the "savings" of earlier restructuring. The hope is that IRS will issue a ruling that the bifurcated debt approach (creating a deferred second mortgage out of that portion of the current debt that cannot be serviced at restructured rents) avoids immediate taxation as "cancellation of indebtedness." Without this favorable ruling, perhaps only the desperate will restructure. Nor is there any solution to the exit tax problem facing owners who face a tax liability on any sale due to their use of prior tax shelter benefits that produced substantial depreciation in basis. Most will simply extend their participation and hang on to get whatever benefits are left via management fees, identity of interest contracts or any permissible cash flow, rather than transfer the property to more responsible parties. Wherever possible, owners may allocate funds away from project needs toward debt service to avoid default, with reductions in housing quality to the detriment of tenants. This will not prove to be a sound system of incentives to ensure quality performance over the long haul. Tax relief should be provided, but only where linked to transfers to tenant-endorsed nonprofit or public ownership.

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POTENTIALLY INADEQUATE ACCOUNTABILITY REFORM. Restructuring under S. 513 is essentially a foreclosure avoidance program for almost all Section 8 "over-subsidized" property owners if there is no real equity value. Beyond substituting new administrators armed with some new enforcement tools, S. 513 contains assurance that project operations will become more responsive to tenants after restructuring. S. 513 apparently presumes that PAE's will be more responsive to residents needs and "bad owners" will be excluded. However, since many PAE's may not have a solid track record of working with deeply subsidized properties and residents, S. 513 should also specify in greater detail the monitoring obligations of the PAE's and the tenants' participation role, although hopefully the overall plan and compensation structure will provide more staff for this essential function than HUD had. The bill should also clarify that tenants may participate in physical inspections whether before or after restructuring (§ 104(f)(2)), and that these should occur no less than annually. The bill should require mechanisms adequate to permit direct tenant empowerment through individual and joint action where owners and regulators are not performing, such as rent withholding for violations or for third-party judicial enforcement rights.

Care should also be taken to ensure that the bill language does not inadvertently inhibit later reform initiatives by Congress, HUD, or PAE's. For example, the requirement that owners accept Section 8 renewals after restructuring if offered "on the same terms and conditions" (§ 105(b)) might prove problematic if owners could claim that any subsequent reforms were new "terms," thereby permitting a rejection of the new term. Some owners could seek to shed the Section 8 contract because the rents will be at or slightly below market, and the second loan will not become payable until retirement of the remaining first mortgage.

INSUFFICIENT TRANSFERS TO TENANTS AND NONPROFITS. S. 513 explicitly encourages transfers only of disqualified "bad owner" properties. Transfers should be encouraged because of the significant capacity developed in the nonprofit sector, which can provide improved local accountability, access to local resources for project or resident needs, and less tension between affordability goals and the potential for private gain. The program should include incentives for marginal owners that would not necessarily be excluded under the narrow "bad owner" screen to exit the program in favor of qualified tenant-endorsed purchasers. This could be accomplished through a combination of a specific funding allocation to assist preservation purchasers, tax relief to cover exit taxes (as suggested in H.R. 1433), and stronger performance review and accountability standards. In addition, for transfers to qualified tenant-endorsed nonprofits, the PAE should have discretion to forgive the deferred second note or subordinate it to permit acquisition financing. (We understand that this provision may be incorporated into the most recent draft of S. 513.) While this would not resolve the owner's exit tax problem, it would provide an important competitive advantage to dedicated purchasers and avoid adverse tax consequences.

LOW REHAB CAP, UNADJUSTED FOR GEOGRAPHICAL VARIATION. The $5,000 cap on Federal contributions toward rehabilitation may not be workable. The cap assumes both geographical consistency and that the owner, purchaser, or the State or local government will be willing and able to contribute the balance of any necessary resources to the property. HUD's data shows that the average repair needs substantially exceed this amount. While S. 513 properly requires a contribution from owners, S. 513's cap on Federal resources (via exception rents, further debt concessions, residual receipts, or rehab grants) will place a substantial number of properties at risk, particularly in high-cost areas, unless rehab needs can be covered from other sources or via reserves built through sound operating budgets negotiated with the PAE's. The cap should be increased, and based upon a multiple of FMR's to inject some degree of geographical variance.

GETTING "BAD OWNERS" OUT OF TROUBLED PROPERTIES. S. 513 explicitly encourages transfers of disqualified "bad owner" properties, but provides no clear way to evict those owners. The program should ensure fast and certain foreclosure consequences because, absent a tax solution, many of these owners will hang on as long as possible despite withdrawal of the Section 8. H.R. 1433's provision exempting HUD and RHS multifamily foreclosures and related actions from the automatic stay provisions of the Bankruptcy Code would be an important addition. Also, HUD and PAE's will need a clear and consistent enforcement plan, adequately staffed and funded. (We understand that the latest draft of S. 513, § 106(e) addresses another key problem by allowing the nonprofit purchaser to renew the Section 8 contract.)

INSUFFICIENT INCENTIVES TO PRESERVE HIGHER VALUE PROPERTIES. The bill provides insufficient incentives for owners to retain some of the inventory's best properties that are exempted from restructuring—whose subsidized rents are currently below true market value—or to transfer these properties for preservation purposes. (The latest draft's language permitting an operating cost adjustment after renewal

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will help for those properties where the gap is small, but not for many others that are sufficiently more valuable than their current Section 8 rent levels to cover conversion costs.) For example, left unprotected are those older assisted properties with below-market rents whose owners would renew with a subsidy closer to FMR, and where an owner's conversion would trigger a Federal obligation to pay replacement tenant-based subsidies at that same higher FMR level!

Similarly, it appears that S. 513 would not provide tools for properties that carry subsidies above objective market levels, or where market values exceed the 120 percent exception rent caps, because they are strong real estate or in higher value submarkets. (We understand that the latest draft may include waiver authority for PAE's to approve budget-based rents in excess of 120 percent of FMR for another category of high-cost units—properties with high operating costs in relation to area FMR's.) Presumably owners of some high-value developments could restructure through forgiveness of good debt, but without a tax solution no owner would have any incentive to do so. None of these properties would be expected to remain in the affordable housing stock.

S. 513 should provide sufficient tools and resources to enable PAE's and owners to preserve these properties as low-income housing; enhanced vouchers to avoid displacement will cost the same as these tools. There is absolutely no good reason to put families and the elderly and the disabled tenants at unnecessary risk of opt-out and displacement.

DISPLACEMENT PROTECTIONS. The Administration's bill, H.R. 1433, provides for "enhanced vouchers" in the event of nonrenewal, increasing the amount of tenant-based assistance to the reasonable rent to avoid economic displacement of tenants. S. 513 should also provide such assistance to all tenants where contracts are not renewed for any reason. Owners should be obligated to accept these vouchers as long as the tenant complies with the lease terms. Any buildings that undergo restructuring but for some reason later lose their project-based Section 8 contracts should be obligated to accept all current resident voucher holders, and refrain from discrimination against tenant-based recipients for all units.

Eligibility for tenant-based assistance (S. 513, § 104(d)) should also be determined as of the date of the termination notice, since some tenants are inevitably driven out by the uncertainty and lack of accurate information. A more specific notice sufficiently prior to *any* termination of project-based assistance must be required, in sufficient time to enable the replacement subsidies to be provided by HUD to the local PHA and then placed by residents in alternative units (two steps consuming around 8 months in other conversion situations and markets).

We appreciate the opportunity to present these views to the Subcommittee, and look forward to working with you and your staff as the development of a Federal restructuring policy advances in the 105th Congress.

PREPARED STATEMENT OF SHEKAR NARASIMHAN

PRESIDENT AND CEO
WASHINGTON MORTGAGE FINANCIAL GROUP, LTD.
ON BEHALF OF THE
MORTGAGE BANKERS ASSOCIATION OF AMERICA

JUNE 17, 1997

Introduction

Mr. Chairman and Members of the Subcommittee, I am Shekar Narasimhan, President and CEO of Washington Mortgage Financial Group, Ltd. Our company originates and services loans for Fannie Mae, Freddie Mac, insurance companies, and private mortgage conduits, as well as loans insured by the Federal Housing Administration (FHA). We service over $7 billion in loans, of which $3.5 billion represent FHA-insured mortgages. Of the FHA-insured loans, 23 percent are secured by projects that are supported by some form of housing assistance payments.

I am very pleased today to address the Subcommittee on behalf of the Mortgage Bankers Association of America (MBA).[1] Washington Mortgage has been a member

[1] MBA is the national association representing exclusively the real estate finance industry. Headquartered in Washington, DC, the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand homeownership pros-

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of MBA for more than 10 years, and I have been an active participant in MBA's many activities throughout that period. I am the Chairman of MBA's Multifamily and Commercial Legislative Subcommittee, the Immediate Past Chairman of MBA's Multifamily Steering Committee, and a Member of MBA's Board of Governors.

Today's hearing on S. 513, a bill to address the many problems relating to the Section 8 rental assistance program, is one of great importance. MBA applauds the Chairman's efforts to restructure the financing and reduce tenant rents for those FHA-insured multifamily projects with above-market rents that currently receive Section 8 subsidies.

MBA believes S. 513 accomplishes the two primary objectives of reducing the long-term cost of the Section 8 program while preserving the HUD-assisted affordable housing stock. It also provides a variety of tools, including FHA multifamily mortgage insurance, that will be needed to successfully restructure rents and mortgages in a manner consistent with the program's goals. It also provides HUD with well-needed direction in implementing the initiatives described in S. 513 while granting the agency some flexibility in how it carries out program requirements.

We appreciate your recent modification of Section 104(a)(2) of the bill that addresses the procedures by which the mortgage restructuring plans are to be written. We understand that the current draft now requires the following: that such plans "shall be developed by the owner, together with the servicing mortgagee, with a participating administrative entity."

We believe that including the servicing mortgagee as an equal participant with the owner in proposing a mortgage restructuring plan will add tremendous value to the process by expediting the mortgage restructuring, reducing the cost to the Government, and assuring that an effective and fair balance will be struck among the goals of maintaining housing affordability, reducing Section 8 expenditures and "right-sizing" the restructured mortgages. MBA believes this was an important change and removes one of our association's two major concerns about S. 513.

We also applaud you on the timeliness of this hearing. We believe it is critical to implement the Section 8 reform and restructuring initiatives as quickly as possible. We strongly encourage you and your colleagues to complete work on this important legislation before the end of the year, and offer our assistance and expertise in that endeavor.

For all the reasons stated above, MBA supports S. 513 and looks forward to working with the Subcommittee to assure its enactment.

Let me also take a few moments to focus the Subcommittee's attention on several areas we believe should be improved before completion. One involves a provision that, if left in the bill, would cause a significant problem for the lending community. Two others are suggestions for improvements we encourage you to consider. I would also like to briefly describe to you MBA's proposal to reform FHA's multifamily programs to permit their future operations without the need for FHA insurance.

Partial Payment of Claim

The language in Section 107(a)(1) of the bill would permit HUD or its designee to force a mortgagee (on behalf of a trustee or lender) to accept a partial payment of claim (prepayment), in a mortgage restructuring, in direct contradiction to the pre-existing contract of insurance entered into by HUD and the mortgagee. This provision, therefore, grants HUD the authority to abrogate its FHA insurance contract with secured mortgagees as a tool to restructure mortgages.

We feel very strongly that this provision is unwarranted and ill-advised, and respectfully encourage you to remove it from the proposed bill. We understand it was included in the legislation because of concern that mortgagees might hold the mortgage restructuring process hostage by insisting that they (on behalf of a trustee or investor) be paid off in full, rather than accept a partial payment of claim.

Although we understand such a concern, we believe the proposed language attempts to solve the perception of a possible problem by prescribing a medicine that will "cure the disease by killing the patient." We also believe the provision reflects a misunderstanding of market realities, lenders'/investors' motivations for making an FHA-insured loan, and the relationship between the lender/investor and its/their loan servicer/mortgagee.

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pects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of nearly 2,700 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies, and others in the mortgage lending field.

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We believe that this provision would likely cause significant disruptions in the financial markets and, indeed, would undermine the efficacy of the mortgage insurance and securitization programs of the FHA and Government National Mortgage Administration (GNMA) mortgage insurance and underwriting programs. If the Government breaches its contractual obligations, as authorized by this provision, investors may be unwilling to commit their capital for affordable multifamily housing in the future because of the fear of future Congressionally-imposed contract abrogations.

Such a provision would also be contrary to all legal precedents and would have far-reaching repercussions that would be far more costly than alternative approaches. It would certainly foster the filing of a number of costly and time-consuming lawsuits. Such lawsuits would distract the Government's attention from other priorities, slow down the process of restructuring mortgages within the program and, to some degree, assure the failure of the proposed legislation. In short, the cost to the Government in time, legal services, and the perception that the Federal Government will not stand by its contractual obligations, will far exceed any costs that would be incurred from the very few mortgagees who might attempt to delay the restructuring process.

Finally, MBA would like to query whether the provision will stand up to a constitutional challenge because it purports to remove a contractual remedy that arises under State law.

For all these reasons, we strongly encourage you to seek a more reasoned approach to addressing your concerns with respect to this issue. We look forward to continuing to work with the Subcommittee and its staff to remove this objectionable provision.

Role of Mortgagee In Restructuring Mortgages

As noted above, MBA very much appreciates your willingness to include qualified mortgagees to participate in the process of restructuring the mortgages. We believe that including them in this process substantially improves the legislation and will help assure that the reforms you seek to impose will be effective and successful.

MBA also believes that Section 104(a)(2), the portion of the legislation that addresses mortgage restructuring issues, would be further improved by describing such procedures in greater detail. MBA has prepared a detailed protocol for quickly and efficiently developing a mortgage restructuring plan, and has provided the Subcommittee staff with its recommendations. These recommendations are based on the procedure currently described in the legislation, but spell out the responsibilities of the parties involved in the restructuring in greater detail and describe a timetable to assure their timely completion. We believe the legislation would be greatly improved if MBA's recommendations with respect to this issue were included, either in the statute itself, or in report language.

Preserving the FHA Mortgage Insurance Fund

S. 513 looks to the FHA multifamily mortgage insurance fund as the source of capital for partial or full prepayments of mortgages to be restructured under the proposed legislation. Because of the potential impact the proposed legislation could have on the FHA fund, we respectfully request that the Subcommittee include language to protect the fund from negative budget and credit scoring impact that could undermine the continued viability of FHA's multifamily programs.

FHA insurance is one of the few Federal programs that currently fosters the production of new or rehabilitated affordable rental housing across the country. It also is critical to the production of nursing homes, assisted-living housing, and hospitals. We believe that, to protect the fund, language must be included that specifically safeguards the currently operating FHA insurance programs from unintended adverse impacts from the solutions to the Section 8 program in the legislation. Only in this manner can we assure that in solving one problem we do not create another.

MBA has prepared several provisions that would accomplish this important objective, and delivered them to the Subcommittee staff. Included is a provision that would permit mortgages to be restructured without the need to appropriate funds for credit subsidy for each mortgage to be restructured under your plan. We encourage you to incorporate these recommendations in the proposed legislation.

Creating a Self-Sustaining FHA Multifamily Mortgage Insurance Fund

MBA believes that the FHA multifamily mortgage insurance programs can operate without the need for an annual appropriation for credit subsidy. MBA has, therefore, developed a detailed set of recommendations that would improve program policies, procedures, and underwriting practices that could assure that, exclusive of personnel and administrative costs, they could, collectively, operate at a profit or break even.

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MBA respectfully encourages the Subcommittee to consider these recommendations and incorporate them in S. 513, at some point, before final approval. In this manner constructive reforms that help reduce the cost of operating one of HUD's critical programs would he set in place and would allow additional staff resources to be allocated to Section 8 reform activities and other important programs.

Conclusion

On behalf of the Mortgage Bankers Association of America and myself, we would like to thank you for this opportunity to address these very important issues. We commend the sponsors of this legislation on the hard work and leadership that has been shown in undertaking to reform the Section 8 programs. Please do not hesitate to call on MBA as the Subcommittee proceeds with its work on the bill. We look forward to working with the Subcommittee to complete the legislation and to gain approval by the Senate Banking Committee and the Congress as a whole.

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June 16, 1997

Senator Connie Mack
Chairman
United States Senate
Subcommittee on Housing Opportunity and Community Development

Dear Mr. Chairman:

This letter responds to your invitation to provide the views of local government elected and appointed officials on S. 513, the "Multifamily Assisted Housing Reform and Affordability Act of 1997." Specifically, the following comments represent the views of the Association of Local Housing Finance Agencies, National Association of Counties, National Association of Housing and Redevelopment Officials, National Community Development Association, and the U.S. Conference of Mayors.

At the outset, we commend the leadership you and Senators D'Amato, Bond, and Bennett have shown in addressing the sharply escalating costs of renewing project-based Section 8 subsidy contracts on FHA-insured projects. We agree with Secretary Cuomo's characterization of the contract renewal problem as "the greatest crisis HUD has ever faced." We urge Congress to enact Section 8 portfolio restructuring legislation as quickly as possible. However, in doing this, we ask that Congress seek to reduce the cost of contract renewals to the Federal Government, while still preserving the stock as affordable housing, providing for needed rehabilitation, and treating the owners of these projects fairly. Our five local government organizations—and the thousands of city and county entities we represent—believe that Congress should consider the following in drafting portfolio restructuring legislation.

1. Eligible Properties

Portfolio re-engineering should include all new construction and substantial rehabilitation, FHA-insured projects where Section 8 contract rents are higher than comparable rents prevailing in the area in which the project is located. Expiring Section 8 subsidy contracts on projects that were publicly financed, but not Federally insured, should be renewed at current rents until restructuring of this stock occurs. This provision would allow these projects to continue to operate while protecting the financing provided by local and State governments. Finally, we recommend that S. 513 be amended to extend eligibility to Section 236 projects.

2. Restructured Rent Levels

Generally, in projects where contract rents exceed the market, the contract rent should be restructured to a market rent or, where there is no comparable market rent, to 90 percent of the Fair Market Rent. However, the legislation should allow the Secretary to grant exceptions to this limit in high-cost areas in which case the rent should track actual operating and maintenance expenses. S. 513 provides for this, allowing the restructured contract rents to increase up to 120 percent of FMR for no more than 20 percent of the units in a jurisdiction in any given year. Furthermore, S. 513 gives the Secretary the authority to waive the 20 percent ceiling in extenuating circumstances. We strongly support this latter provision.

3. Restructuring Entities

Qualified local and State housing agencies should be given preference over private entities to serve as restructuring agents. These agencies are established specifically for the purpose of, and have an on-going interest in, protecting both tenants and the affordable housing stock. We understand, and are very pleased, that S. 513 is being revised to articulate a preference for State *and local* housing finance agencies as "participating administrative entities." To qualify as participating administrative entities under the legislation, these agencies will be required to evidence their qualifications as measured by demonstrated experience in multifamily housing finance, management and staff capability, sound operating procedures, and financial strength. We recommend that S. 513 be further modified to clarify that a participating entity: (a) be allowed to restructure all or some of the eligible projects within its jurisdiction; and, (b) be given the right of first refusal to restructure any project which it financed. Furthermore, we recommend that the legislation grandfather-in any agency that has been approved to participate in the fiscal year 1997 demonstration. These entities have already demonstrated to HUD their capabilities and should not be required to do so again.

We encourage you to include in the Committee Report language directing HUD to establish procedures for delegating restructuring authority among qualified

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HFA's in cases where jurisdictions overlap. Specifically, we recommend that the entities involved be directed to negotiate among themselves as to which agency would perform the restructuring for which eligible projects. In cases where no agreement can be made, HUD should make this determination based on such factors as capacity, including its multifamily housing expertise and asset management capability; whether it financed the project or is currently administering its Section 8 contract; and whether it has adequate resources.

4. Restructuring Tools

Participating administrative entities should have available a broad range of restructuring tools, including full or partial payment of an FHA mortgage insurance claim, refinancing of the debt on a project, the continued availability to receive FHA insurance on the restructured mortgage, risk sharing arrangements, use of residual receipts, and the ability to bifurcate a project's mortgage. We are pleased to see that S. 513 permits all of these restructuring tools. However, we are concerned that there is a $5,000 per unit limitation on the amount of rehabilitation that can take place within the restructuring. In high-cost areas, in particular, the $5,000 limit will be insufficient in many instances. It is also particularly important to ensure that projects are adequately rehabilitated now, because it will be extremely difficult, if not impossible, for a project to attract new long-term capital, either debt or equity, in the future without the long-term commitment of project-based Section 8 that Congress is currently unable to commit. We urge that the legislation be amended to either delete the limit or provide an exception when necessary to meet the needs of a specific project.

In addition, we recommend that the Committee Report note that among the tools which participating administrative entities should use are tax-exempt bonds, including variable rate bonds. Agencies using this technique have the potential to achieve a significant savings which could be applied to paying down the project's debt or financing necessary rehabilitation.

5. Tax Consequences

The ability to bifurcate a project's mortgage into a performing first mortgage and a deferred second mortgage—bearing interest at the applicable Federal rate for a term of up to 50 years—is critical to the success of portfolio re-engineering. This action serves to ease the tax consequences faced by project owners. We urge the Committee to direct or encourage the Internal Revenue Service to rule that the deferred mortgage is deferral of debt and not a form of debt forgiveness.

The portfolio re-engineering demonstration has revealed that the tax consequences inherent in portfolio re-engineering are significant to owners. The Clinton Administration has proposed its version of portfolio re-engineering. That legislation proposes an approach to the vexing question of helping owners mitigate adverse tax consequences by allowing a deferral of taxes based on the level of debt forgiven. While we will leave to others whether this is the appropriate relief, we do believe that the Administration should be commended for recognizing that there are tax consequences involved in re-engineering and for proposing a possible solution. However, we do not believe that there will be any form of tax relief considered this year by the tax-writing committees. Because of this we think it essential that the Committee do all it can to encourage a favorable response from the IRS on mortgage bifurcation.

The Committee should be aware that in some instances (particularly in high-cost areas) virtually all of the current FHA-insured debt will have to be transferred to the second mortgage. Language should be included in S. 513 to make it clear that this huge second mortgage does not immediately become due in instances where the project can support no first mortgage debt upon restructuring. Instead, the owner should have up to 50 years to repay the second mortgage.

6. Transfer to Nonprofits or Public Agencies

Portfolio restructuring legislation should provide for the sale of properties to community-based nonprofits or public agencies. S. 513 provides for this to happen for properties disqualified from restructuring with a preference given to tenant-endorsed community-based nonprofits and public agencies. We believe that the provision should be broadened to allow community-based nonprofit groups and public agencies to be priority purchasers of restructured properties as well. HUD should be given the authority to forgive the second mortgage where there is a transfer to a public agency or nonprofit as a means insuring their financial viability.

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7. Availability of Project-Based Section 8 Assistance and Long-Term Affordability

Project-based Section 8 assistance must continue to be made available to projects undergoing restructuring. Ideally, we would like the Federal Government to show a long-term commitment to the Section 8 program; however, we recognize that, given the fiscal reality, contracts for periods greater than one year is unlikely. Nonetheless, by attaching use restrictions to the mortgage, we believe that Congress can effectively extend the affordability period on any project to 20 or 40 years.

Furthermore, Congress should consider the issue of affordability if Section 8 assistance is no longer available. It is crucial that portfolio re-engineering legislation seek to preserve this valuable housing stock and protect the tenants who reside in it. We suggest that S. 513 be amended to direct restructuring agents to include long-term affordability provisions in restructuring contracts negotiated with project owners. We believe that this can be obtained while still allowing for mixing of tenant incomes up to 80 percent of area median income. Income mixing is ultimately the key to preserving this housing at least cost to the Federal Government.

8. Tenant and Community Participation

We applaud the provision in S. 513 requiring that restructurings be completed in consideration of tenant and community input. We would suggest that the provision be modified to direct participating administrative entities to make available the basis for their decisions when they are inconsistent with either tenant or community desires or the community's consolidated plan.

Fiscal Year 1997 Portfolio Re-engineering Demonstration

On a related matter, the fiscal year 1997 portfolio re-engineering demonstration has highlighted the potential impact permanent restructuring legislation might have and what role State and local housing agencies might assume in these restructurings. The process of establishing, and later implementing, guidelines for the demonstration has been both gratifying and frustrating. We have been pleased with the discourse that took place between representatives of HUD and State and local housing agencies to construct a mutually agreeable methodology of delegating restructuring authority between States and local housing agencies. In this process, HUD came to recognize the technical capability of local housing agencies and their unique position within the local community.

On the other hand, certain aspects of the fiscal year 1997 demonstration have been frustrating. For example, HUD took an extremely long time to publish demonstration guidelines and, when doing so, provided few real details in its instructions to interested State and local housing agencies. Forty-two State and local housing agencies submitted letters of interest to act as designees for restructuring. The fact that only one housing agency has received approval to undertake a restructuring should not be perceived as a lack of interest or lack of capability on the part of State and local housing agencies. Many of those that articulated an interest are currently endeavoring to design thoughtful, comprehensive approaches to restructuring that can be adapted to a diversity of potential projects in their jurisdiction. Although the universe of potential projects in fiscal year 1997 is small, we expect that additional agencies will continue to work with HUD on fiscal year 1997 restructurings. Furthermore, we anticipate that the demonstration will serve as some guidance to expedite the implementation of permanent restructuring legislation.

Again, Mr. Chairman, we applaud your leadership in drafting and promoting Section 8 portfolio re-engineering legislation. We ask that you and the Senate Banking Committee favorably consider our recommendations and that you move expeditiously through debate and markup of S. 513. It is important to our members that the Section 8 funding crisis be dealt with in a manner that preserves the long-term affordability and financial viability of the Section 8 housing stock, encourages the active participation of State and local housing entities in restructuring project mortgages and preserves this vital affordable housing stock. We look forward to working with you as the legislative process moves forward.

We would appreciate your making this letter a part of the record.

Sincerely,

Association of Local Housing Finance Agencies
National Association of Counties
National Association of Housing and Redevelopment Officials
National Community Development Association
U.S. Conference of Mayors

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May 30, 1997

Honorable Connie Mack
Chairman
Subcommittee on Housing Opportunity and Community Development
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

At its May 2, 1997 meeting, the Executive Committee of the National Housing Conference ("NHC") adopted a set of principles that reaffirm its longstanding views on the subject of restructuring the portfolio of privately-owned federally-assisted affordable housing. Enclosed with this letter is a copy of those principles.

NHC would like to take this opportunity to congratulate you for reintroducing a thoughtful, intelligent proposal addressing the fate of project-based Section 8 housing. Like your bill last year, this year's bill, S. 513, the "Multifamily Assisted Housing Reform and Affordability Act of 1997" provides a framework upon which housing providers, state and local officials, residents and resident advocates, and other stakeholders can help you to fashion a sound, long-term solution to a vexing public policy problem.

With appropriate technical modifications[1] your bill will help preserve the nation's irreplaceable supply of privately-owned affordable housing. You are to be commended for sponsoring legislation that contemplates the continuation of project-based assistance, FHA insurance where it is now in place, and a recognition that a range of tools should be available for effectively and efficiently preserving project-based Section 8 housing into the future. We agree with you that the principal responsibility for restructuring the underlying debt on project-based Section 8 housing should be performed by public entities, such as state housing finance agencies, who by definition are accountable to the people.

For your information, NHC would also like you to know that we have found that legislation recently introduced in the House of Representatives, H.R. 1433, "Housing 2020: Multifamily

[1] As you know, legislation recently introduced by Congresswoman Deborah Pryce and Congressman James Moran, while strikingly similar to your own bill, also incorporates some of the technical adjustments that may serve to improve S. 513. Therefore, we would like to commend the Pryce-Moran bill to your attention.

National Housing Conference ◆ 815 Fifteenth Street, N.W., Suite 538 ◆ Washington, D.C. 20005
Telephone (202) 393-5772 ◆ Fax (202) 393-5656 ◆ E-mail nhc@nhc.org

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Management Reform Act," the Clinton Administration's portfolio restructuring proposal, does not appear to be nearly as useful a basis for further dialog as does your proposal.

H.R. 1433 has several weaknesses that make it impossible to use as the basis for developing a successful means of addressing the nation's affordable housing needs. For example, H.R. 1433 does not assure full continuation of project-based assistance, and only does so in limited, specified circumstances. H.R. 1433 provides for the decoupling of rental assistance for those in need and continued FHA insurance (or other credit enhancement) in circumstances where a project can be conveyed to an economically viable third party. In addition, H.R. 1433 does not favor the use of state housing finance agencies, or other units of government, as the entities that will oversee portfolio restructuring, but gives the Secretary of Housing and Urban Development overly broad discretion over choosing which entities (public or private) would serve in such a role.

We do not want to belittle the effort which went behind development of the Clinton Administration legislative proposal. However, in the current budgetary climate, conversion of project-based assistance to tenant-based assistance, except in rare circumstances, risks serious problems for housing providers interested in maintaining their housing in safe, decent and sanitary condition, and it risks homelessness by low income people who may not have a place to use a voucher or tenant-based rental certificate in their own community.

Moreover, by giving the Secretary of Housing and Urban Development broad discretion on whether to use public agencies or private firms as restructuring agents ignores the fact that project-based Section 8 housing was built for the express public purpose of providing decent housing for low and moderate income people, and that public policy requires an ongoing leadership role by a governmental body in the restructuring process. If the Department of Housing and Urban Development, as its workforce declines over time, lacks the capacity to intelligently manage the restructuring of all project-based Section 8 properties, then it becomes the duty of the next level of government -- in effect, state government, acting through its housing finance agencies -- to serve that role. Only if state agencies want to seek the advice and counsel of private firms, both for-profit and non-profit, should such firms be brought into the process.

H.R. 1433 does provide a tax remedy to the liability that will exist through full or partial cancellation of indebtedness of the underlying mortgage. The Administration is to be complimented for appreciating that changes in tax law may be an integral part of this package. We are not convinced that, as currently written, the tax proposal in H.R. 1433 is fair to all housing providers who may be subject to portfolio restructuring. We would like to await revenue estimates with regard to the tax proposal in H.R. 1433 (in order to fully assess its costs and benefits) as well as to compare the tax language in H.R. 1433 with other possible revenue-related remedies.

To reiterate, we believe that S. 513, your bill, should be the basis for further debate on the future of project-based Section 8 housing. To that end, NHC looks forward to working with you, and to help you incorporate any needed technical improvements in the weeks ahead.

Sincerely,

Robert J. Reid
Executive Director

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May 2, 1997

NATIONAL HOUSING CONFERENCE PRINCIPLES ON PORTFOLIO RESTRUCTURING

Since 1993, the National Housing Conference ("NHC"), the nation's oldest affordable housing advocacy organization, has brought together tenants, tenant advocates, for-profit and non-profit housing providers, state, local and federal officials, attorneys, accountants, lenders and other financial intermediaries -- in short, dozens of the key stakeholders concerned about the future of project-based Section 8 housing. Legislation produced by NHC in 1994 was incorporated in omnibus housing legislation that passed the full House and the Senate Banking Committee that year.

Active NHC members helped Senator Connie Mack develop legislation he introduced last year and reintroduced this year aimed at preserving the nation's stock of project-based Section 8 housing while, at the same time, cutting program costs. NHC stands ready to continue its involvement in forging a consensus on how to save this valuable housing in the context of a tight federal budget environment.

On April 23, 1997, Secretary of Housing and Urban Development Andrew Cuomo and Secretary of the Treasury Robert Rubin presented a revised Clinton Administration portfolio reengineering plan concerning FHA-insured project-based Section 8 housing. As indicated above, Senator Mack's proposal was updated and reintroduced as S. 513. Other proposals may also be introduced in the near future.

In light of these developments, NHC would like to take this opportunity to reiterate its longstanding views on some key aspects of the issue:

1) All expiring Section 8 contracts should be renewed for no less than one year at a time, with as much statutory assurance for further renewals as is possible.

2) Where project-based assistance is in force, project-based assistance should continue, unless tenant-based assistance is expressly preferred by all of the stakeholders with an interest in a given project, including residents, project owners and management, and local officials.

3) Any portfolio reengineering program should result in demonstrable cost savings, in outlays as well as in budget authority.

4) Within these cost-saving objectives, no portfolio reengineering plan should be enacted that is harmful to residents, project owners and managers, investors, lenders, and the communities in which project-based Section 8 housing is located.

National Housing Conference ✣ 815 Fifteenth Street, N.W., Suite 711 ✣ Washington, D.C. 20005
Telephone (202) 393-5772 ✣ FAX (202) 393-5656

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5) Any portfolio reengineering plan that creates tax liabilities should be coupled with legislation that minimizes those liabilities to the maximum extent possible.

6) FHA-insured, project-based Section 8 housing should continue to have FHA insurance after the underlying debt is restructured, or alternatively, the remaining debt must contain other equivalent forms of credit enhancement.

7) Properties in need of rehabilitation must be rehabilitated, and portfolio reengineering must produce funds to accomplish that.

8) Debt restructuring should be overseen by public agencies. These designees should have the flexibility to act without undue delay or complications at the federal level.

9) New underwriting must assure that project income will cover costs associated with maintenance, repair, resident programs, reasonable rates of return to project owners, reserves, and if applicable, debt service and taxes.

10) The portfolio restructuring process should encourage, in an equitable manner, an income mix (within Section 8 income limits) and occupancy standards among project residents, in order to foster long term project and community stability.

NHC's involvement, both in conducting its own analyses and in bringing together the widest range of stakeholders, will continue in the weeks and months ahead. Again, we are committed to continue working toward a sound and long-term solution to the question of how best to preserve the nation's stock of project-based Section 8 housing.

In that context, NHC recognizes that a comprehensive solution should include project-based Section 8 housing whose underlying debt is not FHA-insured, as well as older assisted properties requiring special attention in order to assure their long-term viability.

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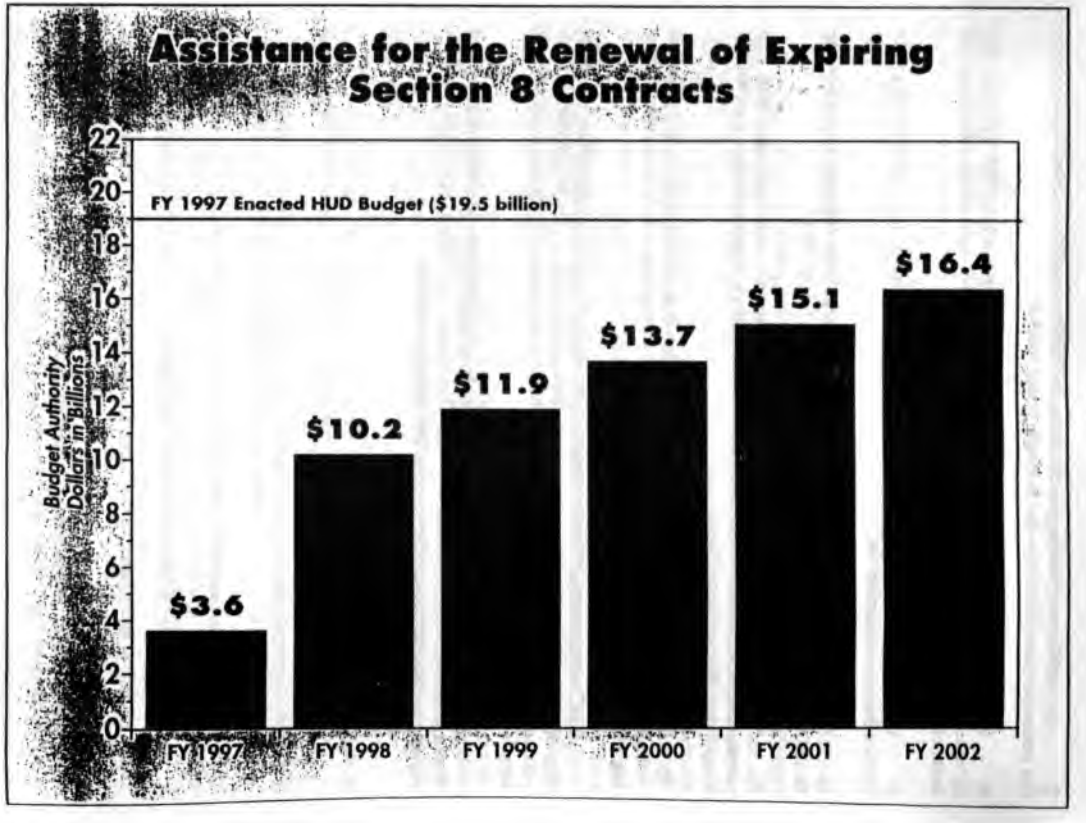
CHART II.



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United States Senate
COMMITTEE ON THE BUDGET
WASHINGTON, DC 20510–6100

June 17, 1997

The Honorable Alfonse M. D'Amato
Chairman
Senate Banking, Housing and Urban Affairs Committee
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Alfonse:

I understand you, along with Senators Mack, Bond, and Bennett, have introduced S. 513, the Multi-Family Assisted Housing Reform and Affordability Act of 1997. I would ask that I be added as a cosponsor of this important legislation.

This legislation seeks to address a multi-faceted crisis in our federal housing programs that has loomed for several years now. In his dual role as Chairman of the VA-HUD Appropriations Subcommittee and member of the Budget Committee, Senator Bond has served us well by warning of the budgetary as well as human implications of oversubsidizing certain housing projects. In addition, Senator Bond's concern for the consequences of not providing sufficient funding to renew expiring Section 8 contracts over the next five years was effectively communicated to budget negotiators, such that the budget resolution includes a reserve fund guaranteeing renewal of the contracts.

Even so, renewal of expiring contracts is not enough, since the lower subsidies that will result from current policy threaten to bankrupt certain projects, triggering potentially large claims on the insurance fund of the Federal Housing Administration. Thanks to Senator Mack and his dogged efforts over the past two years to decipher and improve upon the various proposals to "mark to market" certain housing projects, however, we now have a bill--S. 513--that appears to have the bipartisan support necessary to undertake this important restructuring in the Section 8 program that will reduce anticipated Federal losses.

Finally, under your leadership as Chairman of the Banking Committee, the effort to proceed with S. 513 as a component of your Committee's reconciliation instructions is a worthy goal, and I look forward to working with you on the reconciliation bill during floor consideration. I congratulate you and your co-sponsors for your work, and thank you for the opportunity to advance this timely legislation.

Sincerely,

Pete V. Domenici

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NEW YORK HOUSING CONFERENCE
1780 Broadway, Suite 600 • New York, New York 10019
Tel: (212) 265-6530 • Fax: (212) 757-0571

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STAFF DIRECTOR
Carol Lamberg

June 11, 1997

Honorable Alfonse D'Amato
Honorable Connie Mack
United States Senate
Washington, D.C. 20510

Dear Senator D'Amato and Senator Mack:

The New York Housing Conference is pleased to endorse S. 513, which we believe is the best hope for saving over 50,000 apartments in New York assisted by project-based Section 8. We commend you for introducing legislation that continues project-based assistance, FHA insurance and other measures that will help preserve this vital stock of affordable housing. We are especially pleased with the section of the bill permitting waivers so that all developments in New York that need budget-based renewals can get such assistance. In New York City, the vast majority of Section 8 buildings provide excellent housing, resulting in benefits for both residents and the surrounding neighborhoods. We cannot afford to lose any of these units, and we are grateful that you have the foresight to propose legislation that is workable.

Thank you for sponsoring the legislation, which we hope will be enacted into law. We look forward to working with you to improve and pass the bill.

Sincerely,

Clara Fox
Co-Chair

John Kelly
Co-Chair

Carol Lamberg
Staff Director

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STATEMENT OF MICHAEL BODAKEN

NATIONAL HOUSING TRUST

JUNE 1997

The National Housing Trust believes that S. 513 provides a very useful starting point in reaching a legislative, budgetary, and policy consensus on the crucial issue of the preservation of hundreds of thousands of units of Federally-insured housing stock subject to upcoming Section 8 contract renewals. A solution to this vexing problem is long overdue. S. 513 provides the best chance of resolving the issue this year.

The Trust is a national nonprofit organization formed in 1986, dedicated exclusively to the preservation of affordable, Federally assisted and insured housing. Our board of directors includes representatives of all major interests in the preservation area, including tenant advocates, owners and managers, State housing finance agencies, national and regional nonprofit intermediaries, housing scholars and other housing professionals who care deeply about protecting this irreplaceable resource. The Trust was active in mediating the disparate interests of the housing community during the 1990 LIHPRHA debate and provided technical support to Hill staff on the 1992 and 1994 and proposed 1995 amendments to LIHPRHA. The Trust has been active in the "mark-to-market" debates over the past 3½ years, and currently is developing an active database of "at risk" properties subject to portfolio re-engineering between now and the next decade. So far as we know, it is the only database of its kind which provides, by name and address, expiring Section 8 contracts and the relation of the Section 8 contract level to the local FMR.

The organization serves as an informational clearinghouse on developments for the public and private sector. In addition to its public policy and program monitoring role, the Trust provides technical assistance to resident endorsed nonprofits on sale transactions of Federally assisted and insured developments.

The Need to Preserve Affordable, Federally Assisted and Insured Housing

The Nation's market supply of affordable housing does not currently meet the demand for that product. More low-income Americans pay a higher fraction of their monthly income toward rent than ever before in our Nation's history. This lack of affordable housing, and corresponding lack of financial stability and social status, is particularly problematic for the poor. According to the Joint Center for Housing Studies at Harvard University, the national goal of decent and affordable housing for all Americans remains out of reach because poverty persists and the Nation is losing low-cost rental units from the conventional housing inventory. The Joint Center found that low-cost housing stock declined by 160,000 apartments annually between 1985–1995.

HUD's Assisted Housing Programs: Between 1965 and 1975, over 600,000 units of affordable housing were created by HUD's Section 221(d)(3) and Section 236 housing programs. To this day, this housing is often the only affordable housing located in certain areas that is both affordable and large enough to accommodate large family households. In addition to the original subsidy, a majority of these units later received project-based Section 8 assistance to provide the affordability depth necessary to serve very poor families and the elderly.

Between 1974–1983, an additional 800,000 apartments were developed under the Section 8 New Construction/Substantial Rehabilitation Program (so-called "newer assisted housing stock"). These apartments received Section 8 subsidies in return for which owners were required to rent to low-income families and the elderly. The average income of households residing in this stock is approximately $9,000–$10,000/annually, which is between 10–20 percent of median, nationally.

The Section 8 Contract Renewal Dilemma: In the original design of these programs, Congress provided long-term contracts to owners which were intended to be renewed in like manner at the end of the original term. Thus, it was anticipated that a property with a 40-year mortgage would receive two 20-year Section 8 contracts. Over time, however, Federal budgetary pressures (some would say "accounting issues") made these long-term renewals unsustainable. Also, some of the properties carry very high contract rents, meaning that the Federal Government pays *more* than market rent to maintain these properties as affordable. Congress currently renews these contracts on a year-to-year basis. All of these contracts expire over the next decade. The total number of Section 8 contract renewals is therefore cascading because Congress must, "re-renew" contracts that were renewed the year

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before.[1] The growing amount necessary for Section 8 contract renewal threatens to overwhelm HUD's overall budget. The sweeping budget reselution adopted in May calls for $35 billion over 5 years for these renewals. However, unless lawmakers reach some agreement, the costs could exceed $50 billion over that same timeframe. This problem thus threatens to render insignificant our Nation's other affordable housing problems. We need a solution this year.

The Administration's Original Response

Two and one-half years ago, HUD proposed a profound shift in how the Section 8 program would be made available to owners and residents. HUD proposed to eliminate project-based subsidies as contracts expire; eliminate regulatory requirements governing the housing; pay mortgage claims triggered by the elimination of the subsidy; provide some rehabilitation to a portion of the stock; and provide residents with Section 8 certificates administered by local public housing authorities. That proposal aroused a great deal of uncertainty and galvanized opposition from tenants, nonprofits, local and State housing agencies and for-profit owners. Last year, HUD shifted its emphasis to Section 8 contract rents that were over market and proposed that State or local housing agencies would be given a choice to provide tenant or property-based Section 8 subsidies (although tenant-based subsidies were still strongly encouraged).

The Congressional Reaction

In response to this problem, Congress authorized two consecutive "demonstrations" addressing the need for "portfolio re-engineering." The demonstrations concern themselves with properties with contract rents above 120 percent of the Fair Market Rent. The key to the demonstrations is the introduction of a "bifurcated mortgage," i.e., Section 8 rents would be reduced and the current mortgage would be paid off in whole or in part. New bifurcated debt would be issued, separating the debt into two parts. A new, performing FHA-insured first mortgage would be supported by the reduced cash flow. The second, remainder, is serviced from surplus cash, then would begin a fixed-payment schedule when the first mortgage is paid off. The Section 8 rents are reduced to "market rents" for comparable properties.

S. 513 Helps the Nation Resolve the Section 8 Housing Dilemma at an Affordable Cost to the Taxpayer

The Trust appreciates that the sponsors of S. 513 have taken the time to thoughtfully consider this complex problem which affects so much affordable housing stock and people who call that stock their home. The Trust favors any restructuring proposal that actually helps preserve decent, affordable housing affordable to current and future low-income families and the elderly.

The Trust believes that S. 513 helps break the legislative logjam on "portfolio reengineering" on a number of very crucial issues. The proposal permits projects to be restructured in a manner which permits current and future owners to receive property-based assistance, albeit at lower levels than the current assistance. Also, the proposal recognizes that some properties may not be able to meet operating expenses at the post restructured rent, and permits rents to be set at up to 120 percent of FMR for up to 20 percent of the properties in a particular jurisdiction. The bill recognizes that funds are necessary for tenant and community participation in the restructuring process and potential transfer of the properties. Further, the bill correctly identifies the need for future Federal credit enhancement or insurance of some type to assure long-term financing. Finally, the bill appropriately recognizes that certain owners should not receive the benefits of restructuring.

The Trust urges the U.S. Senate to adopt the following specific recommendations that help assure the public interest is served in the restructuring of this portfolio of properties.

Recommendation No. 1:

The Need for Long-Term Affordability Restrictions to Preserve Housing for the People Who Currently Call it Home Requires Modification of the Present Affordability Targets

The restructuring needs to be accomplished for three reasons: (1) to retain affordable housing stock; (2) to provide tenants decent, safe, and sanitary housing at rents they can afford; and (3) to reduce the long-term discretionary appropriations outlays associated with Section 8 contract rents significantly above the local Fair Market

[1] It's worth noting here that the amount of actual "outlays" spent on this housing is not cascading, i.e., from year-to-year, Congress spends about the same to renew these contracts. But the amount of "budget authority" is increasing because the total renewals expand ever year.

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Rent. The initial "Purpose" articulated in the legislative proposal is *"to preserve low-income rental housing affordability and availability while reducing the long-term costs of Section 8 project-based rental housing subsidies."* (Section 101). The Trust agrees entirely.

After implementation of the restructuring process, the Federal Government will have paid out literally billions of taxpayer dollars in claims from the FHA fund. The properties will have been restored to operate within the market rents prevailing in the community. It would be truly unfortunate if, after dramatic financial re-engineering and cost to the taxpayer, the property is then lost to the Nation's affordable housing stock.

So far, the preservation language of S. 513 essentially requires the owner to accept Section 8 for a period of 20 years from the date of the initial renewal, if the offer to renew is on the same terms and conditions as specified in the original mortgage restructuring agreement. Other so-called "underlying" affordability restrictions are left to the discretion of the Participating Administrative Entity (PAE). While the requirement that owners accept Section 8 is welcome, the Trust suggests:

- That owners be required to accept Section 8 so long as it is offered on the same terms and conditions, i.e., that the 20-year time limit be deleted; and
- That post-restructured rents should run with the 1st and 2nd mortgages, subject to rent increases based on the property's operating budget as approved by the relevant PAE. Over time, it is this type of budget-based affordability determination, as is embodied in the Section 236 and 221(d)(3) housing stock, which provides greater affordability of this housing for generations of future Americans.

Recommendation No. 2:
The Need to Add Older Assisted and LIHPRHA/ELIHPA Projects to the List of Projects Eligible for Restructuring

The Senate should add projects assisted with loan management set aside (LMSA) funds under Section 8(b) of the United States Housing Act of 1937 to the list of properties eligible for restructuring. These projects are typically Section 221(d)(3) BMIR and 236, budget-based properties which received LMSA to meet increasing operating costs. In a minority of the cases, these LMSA contract rent levels now exceed the local FMR. The argument against inclusion is that these properties currently have low unpaid principal balances and below market interest rate mortgages. Therefore, it is assumed that restructuring will not necessarily permit the reduction of post-restructured Section 8 rents at the 90 percent of FMR level. Nevertheless, the Trust is aware of certain properties, in relatively good shape, in this universe that could benefit from restructuring, particularly where the low amount of the debt is written off entirely. Because this is a relatively small number of properties, and because the restructuring would help stabilize otherwise excellent affordable housing, the Trust recommends their inclusion in eligibility for restructuring.

Also, it is vital that the units already preserved under LIHPRHA or ELIHPA be made eligible for restructuring. As you know, many of these projects are now owned by nonprofits who were provided Section 8 financing to sustain the acquisition and rehabilitation of these properties. In other cases, the owner's equity take out was financed by additional Section 8 assistance. For literally tens of thousands of units, the 5-year Section 8 contracts on these properties expire during the next 3–4 years. In many, many cases, these contracts are currently in excess of FMR, with high unpaid principal balances at market interest rates. All of them are HUD insured. These nonprofit owners, most of which purchased the properties with resident support and provided meaningful rehabilitation to these properties, need to know that these properties are eligible for restructuring.

Recommendation No. 3:
Adapting Rehabilitation Limits by Geographic Location

S. 513 recognizes that rehabilitation is necessary to reposition this housing resource for future generations. However, the bill sets an effective limit of $6,250/unit for rehabilitation without regard to the location of the property (one quarter of the costs are to be borne by the existing owner). Without knowing the precise rehabilitation needs of the more than 400,000 units of stock affected by this bill, the Trust is opposed to a particular rehabilitation limit. Moreover, the Trust is concerned that any flat limit will not prove appropriate for all markets. For example, wages in one market will necessarily be higher than wages for the same work in another geographic location. Hence, if the Senate finds it necessary to adopt a rehab constraint, the Senate should explore an adaptive standard which recognizes the varying costs of similar repairs in different locations. While certainly not foolproof, one might explore utilization of a Fair Market Rent, e.g., 12 x FMR, variable rather than a "one size fits all" repair ceiling.

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Recommendation No. 4:
Where an Owner Chooses to Transfer, the Senate Should Encourage Transfers of Ownership to Resident Supported, Nonprofit Purchasers. After Restructuring, If an Owner Chooses to Sell to a Resident Group, Resident Supported Nonprofit or Public Agency, the PAE Should Be Permitted to Waive All or Part of the 2nd Note

The proposal begins to address the transfer of ownership from the for-profit to the nonprofit sector by asking the Secretary to establish procedures for such a transfer where an owner has been disqualified from restructuring. While this is very helpful, there are particular situations which the present language does not yet address. Two particular amendments, which require no increase in cost, are:

(1) The restructuring proposal should declare Congress' intent that, whenever (whether or not the owner has been disqualified) an owner has decided to transfer Federally assisted and insured housing stock, and that decision requires a restructuring of an "eligible multifamily housing project" as defined in the legislation, resident supported nonprofit purchasers and public agencies should be given the right of first offer to purchase the property. While the Trust is fully aware that the proposal does not require transfers of the real estate, we believe it's essential that the Senate acknowledge the very real possibility that such transfers will inevitably take place and, for sound public policy reasons, encourage transfers to resident endorsed nonprofit organizations and public agencies.

(2) To facilitate transfers, S. 513 should provide that, upon disposition of a property *after* restructuring, the PAE could forgive any or all of the accumulated debt on the 2nd note, if the sale was made to a legitimate nonprofit or resident group approved by the PAE. This would help reduce purchase prices and facilitate the transfer of this stock to nonprofits, resident groups, and public agencies. Because financing would be limited to paying for existing first mortgage debt and rehabilitation, more of the capital raised will be used for improvements. Also, rents could be kept lower and HUD's ongoing discretionary Section 8 outlays could be reduced.

The potential restructuring of hundreds of thousands of Section 8 apartments comes at a time when nonprofit organizations are increasingly purchasing, rehabilitating, owning, and managing Federally-assisted housing. Catalyzed over the past 10–15 years by State and Federal legislation encouraging production and preservation of housing by nonprofit organizations, the nonprofit sector has a growing presence in the affordable housing field. State and local governments have successfully utilized nonprofit organizations to preserve and produce housing with tax abatement and relief, tax exempt financing, HOME, CDBG, and the low-income housing tax credit. Nonprofit sponsors have annually produced or preserved over 50,000 units of affordable housing during this time span. In other cases, local housing authorities, seeking to diversify their own portfolio, are becoming interested in purchasing this housing stock. Where local capacity isn't available, regional and national nonprofit organizations have acted as developers and purchasers.

Where a nonprofit organization or public agency seeks to purchase these properties, what value does it introduce to the transaction? There are four obvious ways nonprofits add value: (1) Nonprofit organizations have an interest in involving residents in the long-term ownership and management of these properties and can bring additional resources to help resolve long-term rehabilitation and affordable housing needs; (2) Nonprofit organizations provide limited tax relief to the owner where the owner donates the property to the nonprofit in exchange for a reduced capital gain; (3) Nonprofits will maintain the physical condition and affordability of the stock over time, have no incentives to convert it to market use, and are not pressured to maximize cash flow; and (4) Nonprofit organizations often have a charitable "community development" mission enabling them to access funds for tutoring, job training, emergency food assistance, social services, and other support programs for the residents. Moreover, to the extent that the nonprofit sale is endorsed by the residents, the residents have an opportunity to influence the repair and ongoing management of their homes.

Recommendation No. 5:
Although Clearly Unintended, the Senate Draft Legislative Proposal Requires Tenant-Based Assistance where an Owner has been Rejected for Restructuring, Even Where an Owner Elects to Transfer the Property Per Section 106(e)

Obviously, the nonprofit purchaser of a "disqualified" property wants to step into the shoes of the disqualified owner. However, it is often difficult to impossible to achieve financing for acquisition and rehab with tenant-based assistance. This anomaly can be corrected by inserting the words "The Secretary may include the

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transfer of Section 8 project-based assistance" at the end of Section 106(e) which is the precise wording now included in H.R. 3666, Section 211(b)(4)(b) for owners disqualified from consideration of mortgage restructuring.

Recommendation No. 6:

Articulating the Standard for Screening Out an Owner from the Restructuring Process

S. 513 appropriately provides that the benefits of restructuring should be limited to owners who play by the rules. Section 106(a) prohibits mortgage restructuring by the PAE if the owner has "knowingly and materially" engaged in "material adverse financial or managerial actions." Title II imposes civil money penalties for failing, *inter alia,* to keep the properties in good repair. The Trust urges the Senate to disqualify projects from consideration where the owner has failed, over the past 5 years, to receive HUD 2530 Previous Participation approval due to unsatisfactory management reviews (or other project-related factors). The bill should also encourage HUD to use its present power as debtor in possession to collect rents and exercise greater authority over troubled projects.

Recommendation No. 7:

The Legislation Should Make Clear that Alternative Participating Entities Could Be National or Regional Entities So Long as They Work With Local Community Partners

In the event a State or local housing agency declines to take the lead in restructuring, the Secretary may select other so called "alternative" private entities to perform the work. However, the legislation requires that the alternative PAE be "located" in the State or jurisdiction where the restructuring will take place.

The Trust is aware of numerous national and regional entities with the qualifications to be an alternative PAE, as set forth in the legislation, but which are not "located" in all of the particular jurisdictions affected. Instead, the legislation should require that any private entity selected as an "alternative PAE" have an affiliation with a local community partner located in the jurisdiction. To prevent abuses, the local partner should have been present in the jurisdiction for a set time period previous to the date of passage of the legislation, e.g., two or more years.

Where Do We Go From Here?

The principal barrier to enduring legislative resolution of this issue, to owner participation in portfolio re-engineering, and to satisfactory restructuring of existing mortgages, is the potential tax consequence triggered by debt restructuring. Many owners are understandably concerned that the cancellation of indebtedness resulting from restructuring will be treated as ordinary income by the Internal Revenue Service. Likewise, the owner's negative capital basis prevents the owner from transferring the property due to the significant capital gain associated with a sale. As a consequence, the owners have not stampeded into the HUD demonstration. As of this writing, not more than 10 projects have closed under the two demonstrations authorized by Congress over the past 18 months. Owners who enter the world of restructuring must be assured that they can restructure without significant tax repercussions. Otherwise, participation in restructuring will not be significant.

At this time, it appears that S. 513 may be introduced into the budget reconciliation process. This may renew the opportunity for tax deferral/relief to accompany the restructuring legislation. As this process unfolds, the Trust urges the Senate not to ignore possibilities of encouraging owner participation in restructuring. Participation would be stimulated by providing for profit owners tax deferral for refinance or relief in exchange for sale to a resident group, nonprofit or public agency. Tax mitigation will stimulate *more* participation and, hence, more savings, if owners participate prior to expiration of their contracts.

Some have argued that providing this benefit to owners is a windfall. The Trust respectfully disagrees. While the tax on the non-cash gain triggered by a sale or cancellation of indebtedness occasioned by a refinance is "lost," these dollars would be dwarfed by foreclosure avoidance savings or the failure to receive any tax proceeds when an owner dies and his heirs inherit tax free.

Conclusion

The Trust thanks the sponsors of S. 513 for introducing and moving their Section 8 restructuring legislation. We look forward to working with the Senate and the Senate staff in their attempt to secure passage of portfolio re-engineering legislation this year.

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105TH CONGRESS
1ST SESSION

S. 513

To reform the multifamily rental assisted housing programs of the Federal Government, maintain the affordability and availability of low-income housing, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 21, 1997

Mr. MACK (for himself, Mr. D'AMATO, Mr. BOND, and Mr. BENNETT) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To reform the multifamily rental assisted housing programs of the Federal Government, maintain the affordability and availability of low-income housing, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Multifamily Assisted Housing Reform and Affordability Act of 1997".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

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Sec. 1. Short title; table of contents.

TITLE I—FHA-INSURED MULTIFAMILY HOUSING MORTGAGE AND HOUSING ASSISTANCE RESTRUCTURING

Sec. 101. Findings and purposes.
Sec. 102. Definitions.
Sec. 103. Authority of participating administrative entities.
Sec. 104. Mortgage restructuring and rental assistance sufficiency plan.
Sec. 105. Section 8 renewals and long-term affordability commitment by owner of project.
Sec. 106. Prohibition on restructuring.
Sec. 107. Restructuring tools.
Sec. 108. Shared savings incentive.
Sec. 109. Management standards.
Sec. 110. Monitoring of compliance.
Sec. 111. Review.
Sec. 112. GAO audit and review.
Sec. 113. Regulations.
Sec. 114. Technical and conforming amendments.
Sec. 115. Termination of authority.

TITLE II—ENFORCEMENT PROVISIONS

Sec. 201. Implementation.

Subtitle A—FHA Single Family and Multifamily Housing

Sec. 211. Authorization to immediately suspend mortgagees.
Sec. 212. Extension of equity skimming to other single family and multifamily housing programs.
Sec. 213. Civil money penalties against mortgagees, lenders, and other participants in FHA programs.

Subtitle B—FHA Multifamily

Sec. 220. Civil money penalties against general partners, officers, directors, and certain managing agents of multifamily projects.
Sec. 221. Civil money penalties for noncompliance with section 8 HAP contracts.
Sec. 222. Extension of double damages remedy.
Sec. 223. Obstruction of Federal audits.

TITLE I—FHA-INSURED MULTIFAMILY HOUSING MORTGAGE AND HOUSING ASSISTANCE RESTRUCTURING

SEC. 101. FINDINGS AND PURPOSES.

(a) FINDINGS.—The Congress finds that—

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(1) there exists throughout the Nation a need for decent, safe, and affordable housing;

(2) as of the date of enactment of this Act, it is estimated that—

(A) the insured multifamily housing portfolio of the Federal Housing Administration consists of 14,000 rental properties, with an aggregate unpaid principal mortgage balance of $38,000,000,000; and

(B) approximately 10,000 of these properties contain housing units that are assisted with project-based rental assistance under section 8 of the United States Housing Act of 1937;

(3) FHA-insured multifamily rental properties are a major Federal investment, providing affordable rental housing to an estimated 2,000,000 low- and very low-income families;

(4) approximately 1,600,000 of these families live in dwelling units that are assisted with project-based rental assistance under section 8 of the United States Housing Act of 1937;

(5) a substantial number of housing units receiving project-based assistance have rents that are

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higher than the rents of comparable, unassisted rental units in the same housing rental market;

(6) many of the contracts for project-based assistance will expire during the several years following the date of enactment of this Act;

(7) it is estimated that—

(A) if no changes in the terms and conditions of the contracts for project-based assistance are made before fiscal year 2000, the cost of renewing all expiring rental assistance contracts under section 8 of the United States Housing Act of 1937 for both project-based and tenant-based rental assistance will increase from approximately $3,600,000,000 in fiscal year 1997 to over $14,300,000,000 by fiscal year 2000 and some $22,400,000,000 in fiscal year 2006;

(B) of those renewal amounts, the cost of renewing project-based assistance will increase from $1,200,000,000 in fiscal year 1997 to almost $7,400,000,000 by fiscal year 2006; and

(C) without changes in the manner in which project-based rental assistance is provided, renewals of expiring contracts for project-based rental assistance will require an

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increasingly larger portion of the discretionary budget authority of the Department of Housing and Urban Development in each subsequent fiscal year for the foreseeable future;

(8) absent new budget authority for the renewal of expiring rental contracts for project-based assistance, many of the FHA-insured multifamily housing projects that are assisted with project-based assistance will likely default on their FHA-insured mortgage payments, resulting in substantial claims to the FHA General Insurance Fund and Special Risk Insurance Funds;

(9) more than 15 percent of federally assisted multifamily housing projects are physically or financially distressed, including a number which suffer from mismanagement;

(10) due to Federal budget constraints, the downsizing of the Department of Housing and Urban Development, and diminished administrative capacity, the Department lacks the ability to ensure the continued economic and physical well-being of the stock of federally insured and assisted multifamily housing projects; and

(11) the economic, physical, and management problems facing the stock of federally insured and

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assisted multifamily housing projects will be best served by reforms that—

(A) reduce the cost of Federal rental assistance, including project-based assistance, to these projects by reducing the debt service and operating costs of these projects while retaining the low-income affordability and availability of this housing;

(B) address physical and economic distress of this housing and the failure of some project managers and owners of projects to comply with management and ownership rules and requirements; and

(C) transfer and share many of the loan and contract administration functions and responsibilities of the Secretary with capable State, local, and other entities.

(b) PURPOSES.—The purposes of this title are—

(1) to preserve low-income rental housing affordability and availability while reducing the long-term costs of project-based assistance;

(2) to reform the design and operation of Federal rental housing assistance programs, administered by the Secretary, to promote greater multifamily housing project operating and cost efficiencies;

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(3) to encourage owners of eligible multifamily housing projects to restructure their FHA-insured mortgages and project-based assistance contracts in a manner which is consistent with this title before the year in which the contract expires;

(4) to streamline and improve federally insured and assisted multifamily housing project oversight and administration;

(5) to resolve the problems affecting financially and physically troubled federally insured and assisted multifamily housing projects through cooperation with residents, owners, State and local governments, and other interested entities and individuals; and

(6) to grant additional enforcement tools to use against those who violate agreements and program requirements, in order to ensure that the public interest is safeguarded and that Federal multifamily housing programs serve their intended purposes.

SEC. 102. DEFINITIONS.

For purposes of this title, the following definitions shall apply:

(1) COMPARABLE PROPERTIES.—The term "comparable properties" means properties that are—

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(A) similar to the eligible multifamily housing project in neighborhood (including risk of crime), location, access, street appeal, age, property size, apartment mix, physical configuration, property and unit amenities, and utilities;

(B) unregulated by contractual encumbrances or local rent-control laws; and

(C) occupied predominantly by renters who receive no rent supplements or rental assistance.

(2) ELIGIBLE MULTIFAMILY HOUSING PROJECT.—The term "eligible multifamily housing project" means a property consisting of more than 4 dwelling units—

(A) with rents which, on an average per unit or per room basis, exceed the rent of comparable properties in the same market area, as determined by the Secretary;

(B) that is covered in whole or in part by a contract for project-based assistance under—

(i) the new construction and substantial rehabilitation program under section 8(b)(2) of the United States Housing Act

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of 1937 (as in effect before October 1, 1983);

(ii) the property disposition program under section 8(b) of the United States Housing Act of 1937;

(iii) the moderate rehabilitation program under section 8(e)(2) of the United States Housing Act of 1937;

(iv) the project-based certificate program under section 8 of the United States Housing Act of 1937;

(v) section 23 of the United States Housing Act of 1937 (as in effect before January 1, 1975);

(vi) the rent supplement program under section 101 of the Housing and Urban Development Act of 1965; or

(vii) section 8 of the United States Housing Act of 1937, following conversion from assistance under section 101 of the Housing and Urban Development Act of 1965; and

(C) financed by a mortgage insured under the National Housing Act.

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(3) EXPIRING CONTRACT.—The term "expiring contract" means a project-based assistance contract attached to an eligible multifamily housing project which, under the terms of the contract, will expire.

(4) EXPIRATION DATE.—The term "expiration date" means the date on which an expiring contract expires.

(5) FAIR MARKET RENT.—The term "fair market rent" means the fair market rental established under section 8(c) of the United States Housing Act of 1937.

(6) KNOWING OR KNOWINGLY.—The term "knowing" or "knowingly" means having actual knowledge of or acting with deliberate ignorance or reckless disregard.

(7) LOW-INCOME FAMILIES.—The term "low-income families" has the same meaning as provided under section 3(b)(2) of the United States Housing Act of 1937.

(8) PORTFOLIO RESTRUCTURING AGREEMENT.—The term "Portfolio restructuring agreement" means the agreement entered into between the Secretary and a participating administrative entity, as provided under section 103 of the title.

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(9) PARTICIPATING ADMINISTRATIVE ENTITY.—The term "participating administrative entity" means a public agency, including a State housing finance agency or local housing agency, which meets the requirements under section 103(b).

(10) PROJECT-BASED ASSISTANCE.—The term "project-based assistance" means rental assistance under section 8 of the United States Housing Act of 1937 that is attached to a multifamily housing project.

(11) RENEWAL.—The term "renewal" means the replacement of an expiring Federal rental contract with a new contract under section 8 of the United States Housing Act of 1937, consistent with the requirements of this title.

(12) SECRETARY.—The term "Secretary" means the Secretary of Housing and Urban Development.

(13) STATE.—The term "State" has the same meaning as in section 104 of the Cranston-Gonzalez National Affordable Housing Act.

(14) TENANT-BASED ASSISTANCE.—The term "tenant-based assistance" has the same meaning as in section 8(f) of the United States Housing Act of 1937.

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(15) UNIT OF GENERAL LOCAL GOVERNMENT.—The term "unit of general local government" has the same meaning as in section 104 of the Cranston-Gonzalez National Affordable Housing Act.

(16) VERY LOW-INCOME FAMILY.—The term "very low-income family" has the same meaning as in section 3(b) of the United States Housing Act of 1937.

SEC. 103. AUTHORITY OF PARTICIPATING ADMINISTRATIVE ENTITIES.

(a) PARTICIPATING ADMINISTRATIVE ENTITIES.—

(1) IN GENERAL.—The Secretary shall enter into portfolio restructuring agreements with participating administrative entities for the implementation of mortgage restructuring and rental assistance sufficiency plans to restructure FHA-insured multifamily housing mortgages, in order to—

(A) reduce the costs of current and expiring contracts for assistance under section 8 of the United States Housing Act of 1937;

(B) address financially and physically troubled projects; and

(C) correct management and ownership deficiencies.

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(2) PORTFOLIO RESTRUCTURING AGREEMENTS.—Each portfolio restructuring agreement entered into under this subsection shall—

(A) be a cooperative agreement to establish the obligations and requirements between the Secretary and the participating administrative entity;

(B) identify the eligible multifamily housing projects or groups of projects for which the participating administrative entity is responsible for assisting in developing and implementing approved mortgage restructuring and rental assistance sufficiency plans under section 104;

(C) require the participating administrative entity to review and certify to the accuracy and completeness of a comprehensive needs assessment submitted by the owner of an eligible multifamily housing project, in accordance with the information and data requirements of section 403 of the Housing and Community Development Act of 1992, including such other data, information, and requirements as the Secretary may require to be included as part of the comprehensive needs assessment;

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(D) identify the responsibilities of both the participating administrative entity and the Secretary in implementing a mortgage restructuring and rental assistance sufficiency plan, including any actions proposed to be taken under section 106 or 107;

(E) require each mortgage restructuring and rental assistance sufficiency plan to be prepared in accordance with the requirements of section 104 for each eligible multifamily housing project;

(F) indemnify the participating administrative entity against lawsuits and penalties for actions taken pursuant to the agreement, excluding actions involving gross negligence or willful misconduct; and

(G) include compensation for all reasonable expenses incurred by the participating administrative entity necessary to perform its duties under this Act, including such incentives as may be authorized under section 108.

(b) SELECTION OF PARTICIPATING ADMINISTRATIVE ENTITY.—

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(1) SELECTION CRITERIA.—The Secretary shall select a participating administrative entity based on the following criteria—

(A) is located in the State or local jurisdiction in which the eligible multifamily housing project or projects are located;

(B) has demonstrated expertise in the development or management of low-income affordable rental housing;

(C) has a history of stable, financially sound, and responsible administrative performance;

(D) has demonstrated financial strength in terms of asset quality, capital adequacy, and liquidity; and

(E) is otherwise qualified, as determined by the Secretary, to carry out the requirements of this title.

(2) SELECTION OF MORTGAGE RISK-SHARING ENTITIES.—Any State housing finance agency or local housing agency which is designated as a qualified participating entity under section 542 of the Housing and Community Development Act of 1992 shall automatically qualify as a participating administrative entity under this section.

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(3) ALTERNATIVE ADMINISTRATORS.—With respect to any eligible multifamily housing project that is located in a State or local jurisdiction in which the Secretary determines that a participating administrative entity is not located, is unavailable, or does not qualify, the Secretary shall either—

(A) carry out the requirements of this title with respect to that eligible multifamily housing project; or

(B) contract with other qualified entities that meet the requirements of subsection (b), with the exception of subsection (b)(1)(A), the authority to carry out all or a portion of the requirements of this title with respect to that eligible multifamily housing project.

(4) PREFERENCE FOR STATE HOUSING FINANCE AGENCIES AS PARTICIPATING ADMINISTRATIVE ENTITIES.—For each State in which eligible multifamily housing projects are located, the Secretary shall give preference to the housing finance agency of that State or, if a State housing finance agency is unqualified or has declined to participate, a local housing agency to act as the participating administrative entity for that State or for the jurisdiction in which the agency located.

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(5) STATE PORTFOLIO REQUIREMENTS.—

(A) IN GENERAL.—If the housing finance agency of a State is selected as the participating administrative entity, that agency shall be responsible for all eligible multifamily housing projects in that State, except that a local housing agency selected as a participating administrative entity shall be responsible for all eligible multifamily housing projects in the jurisdiction of the agency.

(B) DELEGATION.—A participating administrative entity may delegate or transfer responsibilities and functions under this title to one or more interested and qualified public entities.

(C) WAIVER.—A State housing finance agency or local housing agency may request a waiver from the Secretary from the requirements of this paragraph for good cause.

SEC. 104. MORTGAGE RESTRUCTURING AND RENTAL ASSISTANCE SUFFICIENCY PLAN.

(a) IN GENERAL.—

(1) DEVELOPMENT OF PROCEDURES AND REQUIREMENTS.—The Secretary shall develop procedures and requirements for the submission of a mortgage restructuring and rental assistance suffi-

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ciency plan for each eligible multifamily housing project with an expiring contract.

(2) TERMS AND CONDITIONS.—Each mortgage restructuring and rental assistance sufficiency plan submitted under this subsection shall be developed at the initiative of an owner of an eligible multifamily housing project with a participating administrative entity, under such terms and conditions as the Secretary shall require.

(3) CONSOLIDATION.—Mortgage restructuring and rental assistance sufficiency plans submitted under this subsection may be consolidated as part of an overall strategy for more than one property.

(b) NOTICE REQUIREMENTS.—The Secretary shall establish notice procedures and hearing requirements for tenants and owners concerning the dates for the expiration of project-based assistance contracts for any eligible multifamily housing project.

(c) EXTENSION OF CONTRACT TERM.—Subject to agreement by a project owner, the Secretary may extend the term of any expiring contract or provide a section 8 contract with rent levels set in accordance with subsection (g) for a period sufficient to facilitate the implementation of a mortgage restructuring and rental assistance sufficiency plan, as determined by the Secretary.

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(d) TENANT RENT PROTECTION.—If the owner of a project with an expiring Federal rental assistance contract does not agree to extend the contract, the Secretary shall make tenant-based assistance available to tenants residing in units assisted under the expiring contract at the time of expiration.

(e) MORTGAGE RESTRUCTURING AND RENTAL ASSISTANCE SUFFICIENCY PLAN.—Each mortgage restructuring and rental assistance sufficiency plan shall—

(1) except as otherwise provided, restructure the project-based assistance rents for the eligible multifamily housing project in a manner consistent with subsection (g);

(2) require the owner or purchaser of an eligible multifamily housing project with an expiring contract to submit to the participating administrative entity a comprehensive needs assessment, in accordance with the information and data requirements of section 403 of the Housing and Community Development Act of 1992, including such other data, information, and requirements as the Secretary may require to be included as part of the comprehensive needs assessment;

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(3) require the owner or purchaser of the project to provide or contract for competent management of the project;

(4) require the owner or purchaser of the project to take such actions as may be necessary to rehabilitate, maintain adequate reserves, and to maintain the project in decent and safe condition, based on housing quality standards established by—

(A) the Secretary; or

(B) local housing codes or codes adopted by public housing agencies that—

(i) meet or exceed housing quality standards established by the Secretary; and

(ii) do not severely restrict housing choice;

(5) require the owner or purchaser of the project to maintain affordability and use restrictions for 20 years, as the participating administrative entity determines to be appropriate, which restrictions shall be consistent with the long-term physical and financial viability character of the project as affordable housing;

(6) meet subsidy layering requirements under guidelines established by the Secretary; and

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(7) require the owner or purchaser of the project to meet such other requirements as the Secretary determines to be appropriate.

(f) TENANT AND COMMUNITY PARTICIPATION AND CAPACITY BUILDING.—

(1) PROCEDURES.—

(A) IN GENERAL.—The Secretary shall establish procedures to provide an opportunity for tenants of the project and other affected parties, including local government and the community in which the project is located, to participate effectively in the restructuring process established by this title.

(B) CRITERIA.—These procedures shall include—

(i) the rights to timely and adequate written notice of the proposed decisions of the owner or the Secretary or participating administrative entity;

(ii) timely access to all relevant information (except for information determined to be proprietary under standards established by the Secretary);

(iii) an adequate period to analyze this information and provide comments to

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the Secretary or participating administrative entity (which comments shall be taken into consideration by the participating administrative entity); and

(iv) if requested, a meeting with a representative of the participating administrative entity and other affected parties.

(2) PROCEDURES REQUIRED.—The procedures established under paragraph (1) shall permit tenant, local government, and community participation in at least the following decisions or plans specified in this title:

(A) The Portfolio Restructuring Agreement.

(B) Any proposed expiration of the section 8 contract.

(C) The project's eligibility for restructuring pursuant to section 106 and the mortgage restructuring and rental assistance sufficiency plan pursuant to section 104.

(D) Physical inspections.

(E) Capital needs and management assessments, whether before or after restructuring.

(F) Any proposed transfer of the project.

(3) FUNDING.—

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(A) IN GENERAL.—The Secretary may provide not more than $10,000,000 annually in funding to tenant groups, nonprofit organizations, and public entities for building the capacity of tenant organizations, for technical assistance in furthering any of the purposes of this title (including transfer of developments to new owners) and for tenant services, from those amounts made available under appropriations Acts for implementing this title.

(B) ALLOCATION.—The Secretary may allocate any funds made available under subparagraph (A) through existing technical assistance programs and procedures developed pursuant to any other Federal law, including the Low-Income Housing Preservation and Resident Homeownership Act of 1990 and the Multifamily Property Disposition Reform Act of 1994.

(C) PROHIBITION.—None of the funds made available under subparagraph (A) may be used directly or indirectly to pay for any personal service, advertisement, telegram, telephone, letter, printed or written matter, or other device, intended or designed to influence in any manner a Member of Congress, to favor

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or oppose, by vote or otherwise, any legislation or appropriation by the Congress, whether before or after the introduction of any bill or resolution proposing such legislation or appropriation.

(g) RENT LEVELS.—

(1) IN GENERAL.—Except as provided in paragraph (2), each mortgage restructuring and rental assistance sufficiency plan pursuant to the terms, conditions, and requirements of this title shall establish for units assisted with project-based assistance in eligible multifamily housing projects adjusted rent levels that—

(A) are equivalent to rents derived from comparable properties, if—

(i) the participating administrative entity makes the rent determination not later than 120 days after the owner submits a mortgage restructuring and rental assistance sufficiency plan; and

(ii) the market rent determination is based on not less than 2 comparable properties; or

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(B) if those rents cannot be determined, are equal to 90 percent of the fair market rents for the relevant market area.

(2) EXCEPTIONS.—

(A) IN GENERAL.—A contract under this section may include rent levels that exceed the rent level described in paragraph (1) at rent levels that do not exceed 120 percent of the local fair market rent if the participating administrative entity—

(i) determines, that the housing needs of the tenants and the community cannot be adequately addressed through implementation of the rent limitation required to be established through a mortgage restructuring and rental assistance sufficiency plan under paragraph (1); and

(ii) follows the procedures under paragraph (3).

(B) EXCEPTION RENTS.—In any fiscal year, a participating administrative entity may approve exception rents on not more than 20 percent of all units in the geographic jurisdiction of the entity with expiring contracts in that fiscal year, except that the Secretary may waive

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this ceiling upon a finding of special need in the geographic area served by the participating administrative entity.

(3) RENT LEVELS FOR EXCEPTION PROJECTS.—For purposes of this section, a project eligible for an exception rent shall receive a rent calculation on the actual and projected costs of operating the project, at a level that provides income sufficient to support a budget-based rent that consists of—

(A) the debt service of the project;

(B) the operating expenses of the project, as determined by the participating administrative entity, including—

(i) contributions to adequate reserves;

(ii) the costs of maintenance and necessary rehabilitation; and

(iii) other eligible costs permitted under section 8 of the United States Housing Act of 1937;

(C) an adequate allowance for potential operating losses due to vacancies and failure to collect rents, as determined by the participating administrative entity;

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(D) an allowance for a reasonable rate of return to the owner or purchaser of the project, as determined by the participating administrative entity, which may be established to provide incentives for owners or purchasers to meet benchmarks of quality for management and housing quality; and

(E) other expenses determined by the participating administrative entity to be necessary for the operation of the project.

(h) EXEMPTIONS FROM RESTRUCTURING.—Subject to section 106, the Secretary shall renew project-based assistance sufficiency contracts at existing rents if—

(1) the project was financed through obligations such that the implementation of a mortgage restructuring and rental assistance sufficiency plan under this section is inconsistent with applicable law or agreements governing such financing;

(2) in the determination of the Secretary or the participating administrative entity, the restructuring would not result in significant savings to the Secretary; or

(3) the project has an expiring contract under section 8 of the United States Housing Act of 1937

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but does not qualify as an eligible multifamily housing project pursuant to section 102(2) of this title.

SEC. 105. SECTION 8 RENEWALS AND LONG-TERM AFFORDABILITY COMMITMENT BY OWNER OF PROJECT.

(a) SECTION 8 RENEWALS OF RESTRUCTURED PROJECTS.—Subject to the availability of amounts provided in advance in appropriations Acts, the Secretary shall enter into contracts with participating administrative entities pursuant to which the participating administrative entity shall offer to renew or extend an expiring section 8 contract on an eligible multifamily housing project, and the owner of the project shall accept the offer, provided the initial renewal is in accordance with the terms and conditions specified in the mortgage restructuring and rental assistance sufficiency plan.

(b) REQUIRED COMMITMENT.—After the initial renewal of a section 8 contract pursuant to this section, the owner shall accept each offer made pursuant to subsection (a) to renew the contract, for a period of 20 years from the date of the initial renewal, if the offer to renew is on terms and conditions specified in the mortgage restructuring and rental assistance sufficiency plan.

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SEC. 106. PROHIBITION ON RESTRUCTURING.

(a) PROHIBITION ON RESTRUCTURING.—The Secretary shall not consider any mortgage restructuring and rental assistance sufficiency plan or request for contract renewal if the participating administrative entity determines that—

(1) the owner or purchaser of the project has engaged in material adverse financial or managerial actions or omissions with regard to this project (or with regard to other similar projects if the Secretary determines that those actions or omissions constitute a pattern of mismanagement that would warrant suspension or debarment by the Secretary), including—

(A) knowingly and materially violating any Federal, State, or local law or regulation with regard to this project or any other federally assisted project;

(B) knowingly and materially breaching a contract for assistance under section 8 of the United States Housing Act of 1937;

(C) knowingly and materially violating any applicable regulatory or other agreement with the Secretary or a participating administrative entity;

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(D) repeatedly failing to make mortgage payments at times when project income was sufficient to maintain and operate the property;

(E) materially failing to maintain the property according to housing quality standards after receipt of notice and a reasonable opportunity to cure; or

(F) committing any actions or omissions that would warrant suspension or debarment by the Secretary;

(2) the owner or purchaser of the property materially failed to follow the procedures and requirements of this title, after receipt of notice and an opportunity to cure; or

(3) the poor condition of the project cannot be remedied in a cost effective manner, as determined by the participating administrative entity.

(b) OPPORTUNITY TO DISPUTE FINDINGS.—

(1) IN GENERAL.—During the 30-day period beginning on the date on which the owner or purchaser of an eligible multifamily housing project receives notice of a rejection under subsection (a) or of a mortgage restructuring and rental assistance sufficiency plan under section 104, the Secretary or participating administrative entity shall provide that

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owner or purchaser with an opportunity to dispute the basis for the rejection and an opportunity to cure.

(2) AFFIRMATION, MODIFICATION, OR REVERSAL.—

(A) IN GENERAL.—After providing an opportunity to dispute under paragraph (1), the Secretary or the participating administrative entity may affirm, modify, or reverse any rejection under subsection (a) or rejection of a mortgage restructuring and rental assistance sufficiency plan under section 104.

(B) REASONS FOR DECISION.—The Secretary or the participating administrative entity, as applicable, shall identify the reasons for any final decision under this paragraph.

(C) REVIEW PROCESS.—The Secretary shall establish an administrative review process to appeal any final decision under this paragraph.

(c) FINAL DETERMINATION.—Any final determination under this section shall not be subject to judicial review.

(d) DISPLACED TENANTS.—Subject to the availability of amounts provided in advance in appropriations Acts,

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for any low-income tenant that is residing in a project or receiving assistance under section 8 of the United States Housing Act of 1937 at the time of rejection under this section, that tenant shall be provided with tenant-based assistance and reasonable moving expenses, as determined by the Secretary.

(e) TRANSFER OF PROPERTY.—For properties disqualified from the consideration of a mortgage restructuring and rental assistance sufficiency plan under this section because of actions by an owner or purchaser in accordance with paragraph (1) or (2) of subsection (a), the Secretary shall establish procedures to facilitate the voluntary sale or transfer of a property as part of a mortgage restructuring and rental assistance sufficiency plan, with a preference for tenant organizations and tenant-endorsed community-based nonprofit and public agency purchasers meeting such reasonable qualifications as may be established by the Secretary.

SEC. 107. RESTRUCTURING TOOLS.

(a) RESTRUCTURING TOOLS.—For purposes of this title, and to the extent these actions are consistent with this section, an approved mortgage restructuring and rental assistance sufficiency plan may include one or more of the following:

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(1) FULL OR PARTIAL PAYMENT OF CLAIM.—Making a full payment of claim or partial payment of claim under section 541(b) of the National Housing Act. Any payment under this paragraph shall not require the approval of a mortgage.

(2) REFINANCING OF DEBT.—Refinancing of all or part of the debt on a project, if the refinancing would result in significant subsidy savings under section 8 of the United States Housing Act of 1937.

(3) MORTGAGE INSURANCE.—Providing FHA multifamily mortgage insurance, reinsurance or other credit enhancement alternatives, including multifamily risk-sharing mortgage programs, as provided under section 542 of the Housing and Community Development Act of 1992. Any limitations on the number of units available for mortgage insurance under section 542 shall not apply to eligible multifamily housing projects. Any credit subsidy costs of providing mortgage insurance shall be paid from the General Insurance Fund and the Special Risk Insurance Fund.

(4) CREDIT ENHANCEMENT.—Any additional State or local mortgage credit enhancements and risk-sharing arrangements may be established with State or local housing finance agencies, the Federal

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Housing Finance Board, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation, to a modified first mortgage.

(5) COMPENSATION OF THIRD PARTIES.—Entering into agreements, incurring costs, or making payments, as may be reasonably necessary, to compensate the participation of participating administrative entities and other parties in undertaking actions authorized by this title. Upon request, participating administrative entities shall be considered to be contract administrators under section 8 of the United States Housing Act of 1937 for purposes of any contracts entered into as part of an approved mortgage restructuring and rental assistance sufficiency plan.

(6) RESIDUAL RECEIPTS.—Applying any acquired residual receipts to maintain the long-term affordability and physical condition of the property. The participating administrative entity may expedite the acquisition of residual receipts by entering into agreements with owners of housing covered by an expiring contract to provide an owner with a share of the receipts, not to exceed 10 percent.

(7) REHABILITATION NEEDS.—Assisting in addressing the necessary rehabilitation needs of the

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project, except that assistance under this paragraph shall not exceed the equivalent of $5,000 per unit for those units covered with project-based assistance. Rehabilitation may be paid from the provision of grants from residual receipts or, as provided in appropriations Acts, from budget authority provided for increases in the budget authority for assistance contracts under section 8 of the United States Housing Act of 1937, or through the debt restructuring transaction. Each owner that receives rehabilitation assistance shall contribute not less than 25 percent of the amount of rehabilitation assistance received.

(8) MORTGAGE RESTRUCTURING.—Restructuring mortgages to provide a structured first mortgage to cover rents at levels that are established in section 104(g) and a second mortgage equal to the difference between the restructured first mortgage and the mortgage balance of the eligible multifamily housing project at the time of restructuring. The second mortgage shall bear interest at a rate not to exceed the applicable Federal rate for a term not to exceed 50 years. If the first mortgage remains outstanding, payments of interest and principal on the second mortgage shall be made from all excess

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project income only after the payment of all reasonable and necessary operating expenses (including deposits in a reserve for replacement), debt service on the first mortgage, and such other expenditures as may be approved by the Secretary. During the period in which the first mortgage remains outstanding, no payments of interest or principal shall be required on the second mortgage. The second mortgage shall be assumable by any subsequent purchaser of any multifamily housing project, pursuant to guidelines established by the Secretary. The principal and accrued interest due under the second mortgage shall be fully payable upon disposition of the property, unless the mortgage is assumed under the preceding sentence. The owner shall begin repayment of the second mortgage upon full payment of the first mortgage in equal monthly installments in an amount equal to the monthly principal and interest payments formerly paid under the first mortgage. The principal and interest of a second mortgage shall be immediately due and payable upon a finding by the Secretary that an owner has failed to materially comply with this title or any requirements of the United States Housing Act of 1937 as those requirements apply to the applicable

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project, after receipt of notice of such failure and a reasonable opportunity to cure such failure. The second mortgage may be a direct obligation of the Secretary or a loan financed through a lender, other than the Secretary. Any credit subsidy costs of providing a second mortgage shall be paid from the General Insurance Fund and the Special Risk Insurance Fund.

(b) ROLE OF FNMA AND FHLMC.—Section 1335 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4565) is amended—

(1) in paragraph (3), by striking "and" at the end;

(2) paragraph (4), by striking the period at the end and inserting "; and";

(3) by striking "To meet" and inserting the following:

"(a) IN GENERAL.—To meet"; and

(4) by adding at the end the following:

"(5) assist in maintaining the affordability of assisted units in eligible multifamily housing projects with expiring contracts, as defined under the Multifamily Assisted Housing Reform and Affordability Act of 1996.

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"(b) AFFORDABLE HOUSING GOALS.—Actions taken under subsection (a)(5) shall constitute part of the contribution of each entity in meeting their affordable housing goals under sections 1332, 1333, and 1334 for any fiscal year, as determined by the Secretary.".

(c) PROHIBITION ON EQUITY SHARING BY THE SECRETARY.—The Secretary is prohibited from participating in any equity agreement or profit-sharing agreement in conjunction with any eligible multifamily housing project.

SEC. 108. SHARED SAVINGS INCENTIVE.

(a) IN GENERAL.—At the time a participating administrative entity is designated, the Secretary shall negotiate an incentive agreement with the participating administrative entity, which agreement may provide such entity with a share of savings from any restructured mortgage and reduced subsidies resulting from actions under section 107. The Secretary shall negotiate with participating administrative entities a savings incentive formula that provides for periodic payments over a 5-year period, which is allocated as incentives to participating administrative entities.

(b) USE OF SAVINGS.—Notwithstanding any other provision of law, the incentive agreement under subsection (a) shall require any savings provided to a participating administrative entity under that agreement to be used only

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for providing decent, safe, and affordable housing for very low-income families and persons with a priority for eligible multifamily housing projects.

SEC. 109. MANAGEMENT STANDARDS.

Each participating administrative entity shall establish and implement management standards, including requirements governing conflicts of interest between owners, managers, contractors with an identity of interest, pursuant to guidelines established by the Secretary and consistent with industry standards.

SEC. 110. MONITORING OF COMPLIANCE.

(a) COMPLIANCE AGREEMENTS.—Pursuant to regulations issued by the Secretary after public notice and comment, each participating administrative entity, through binding contractual agreements with owners and otherwise, shall ensure long-term compliance with the provisions of this title. Each agreements shall, at a minimum, provide for—

(1) enforcement of the provisions of this title; and

(2) remedies for the breach of those provisions.

(b) PERIODIC MONITORING.—

(1) IN GENERAL.—Not less than annually, each participating administrative entity shall review the status of all multifamily housing projects for which

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a mortgage restructuring and rental assistance sufficiency plan has been implemented.

(2) INSPECTIONS.—Each review under this subsection shall include onsite inspection to determine compliance with housing codes and other requirements as provided in this title and the portfolio restructuring agreements.

(c) AUDIT BY THE SECRETARY.—The Comptroller General of the United States, the Secretary, and the Inspector General of the Department of Housing and Urban Development may conduct an audit at any time of any multifamily housing project for which a mortgage restructuring and rental assistance sufficiency plan has been implemented.

SEC. 111. REVIEW.

(a) ANNUAL REVIEW.—In order to ensure compliance with this title, the Secretary shall conduct an annual review and report to the Congress on actions taken under this title and the status of eligible multifamily housing projects.

(b) SUBSIDY LAYERING REVIEW.—The participating administrative entity shall certify, pursuant to guidelines issued by the Secretary, that the requirements of section 102(d) of the Department of Housing and Urban Development Reform Act of 1989 are satisfied so that the com-

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bination of assistance provided in connection with a property for which a mortgage is to be restructured shall not be any greater than is necessary to provide affordable housing.

SEC. 112. GAO AUDIT AND REVIEW.

(a) INITIAL AUDIT.—Not later than 18 months after the effective date of interim or final regulations promulgated under this title, the Comptroller General of the United States shall conduct an audit to evaluate a representative sample of all eligible multifamily housing projects and the implementation of all mortgage restructuring and rental assistance sufficiency plans.

(b) REPORT.—

(1) IN GENERAL.—Not later than 18 months after the audit conducted under subsection (a), the Comptroller General of the United States shall submit to the Congress a report on the status of all eligible multifamily housing projects and the implementation of all mortgage restructuring and rental assistance sufficiency plans.

(2) CONTENTS.—The report submitted under paragraph (1) shall include—

(A) a description of the initial audit conducted under subsection (a); and

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(B) recommendations for any legislative action to increase the financial savings to the Federal Government of the restructuring of eligible multifamily housing projects balanced with the continued availability of the maximum number of affordable low-income housing units.

SEC. 113. REGULATIONS.

(a) RULEMAKING AND IMPLEMENTATION.—The Secretary shall issue interim regulations necessary to implement this title not later than the expiration of the 6-month period beginning on the date of enactment of this Act. Not later than 1 year after the date of enactment of this Act, in accordance with the negotiated rulemaking procedures set forth in subchapter III of chapter 5 of title 5, United States Code, the Secretary shall implement final regulations implementing this title.

(b) REPEAL OF FHA MULTIFAMILY HOUSING DEMONSTRATION AUTHORITY.—

(1) IN GENERAL.—Beginning upon the expiration of the 6-month period beginning on the date of enactment of this Act, the Secretary may not exercise any authority or take any action under section 210 of the Balanced Budget Down Payment Act, II.

(2) UNUSED BUDGET AUTHORITY.—Any unused budget authority under section 210(f) of the

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Balanced Budget Down Payment Act, II, shall be available for taking actions under the requirements established through regulations issued under subsection (a).

SEC. 114. TECHNICAL AND CONFORMING AMENDMENTS.

(a) CALCULATION OF LIMIT ON PROJECT-BASED ASSISTANCE.—Section 8(d) of the United States Housing Act of 1937 (42 U.S.C. 1437f(d)) is amended by adding at the end the following new paragraph:

"(5) CALCULATION OF LIMIT.—Any contract entered into under section 104 of the Multifamily Assisted Housing Reform and Affordability Act of 1997 shall be excluded in computing the limit on project-based assistance under this subsection.".

(b) PARTIAL PAYMENT OF CLAIMS ON MULTIFAMILY HOUSING PROJECTS.—Section 541 of the National Housing Act (12 U.S.C. 1735f–19) is amended—

(1) in subsection (a), in the subsection heading, by striking "AUTHORITY" and inserting "DEFAULTED MORTGAGES";

(2) by redesignating subsection (b) as subsection (c); and

(3) by inserting after subsection (a) the following new subsection:

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"(b) EXISTING MORTGAGES.—Notwithstanding any other provision of law, the Secretary, in connection with a mortgage restructuring under section 104 of the Multifamily Assisted Housing Reform and Affordability Act of 1997, may make a one time, nondefault partial payment of the claim under the mortgage insurance contract, which shall include a determination by the Secretary or the participating administrative entity, in accordance with the Multifamily Assisted Housing Reform and Affordability Act of 1997, of the market value of the project and a restructuring of the mortgage, under such terms and conditions as the Secretary may establish.".

SEC. 115. TERMINATION OF AUTHORITY.

(a) IN GENERAL.—Except as provided in subsection (b), this title is repealed effective October 1, 2002.

(b) EXCEPTION.—The repeal under this section does not apply with respect to projects and programs for which binding commitments have been entered into before October 1, 2002.

TITLE II—ENFORCEMENT PROVISIONS

SEC. 201. IMPLEMENTATION.

(a) ISSUANCE OF NECESSARY REGULATIONS.—Notwithstanding section 7(o) of the Department of Housing and Urban Development Act or part 10 of title 24, Code

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of Federal Regulations (as in existence on the date of enactment of this Act), the Secretary shall issue such regulations as the Secretary determines to be necessary to implement this title and the amendments made by this title in accordance with section 552 or 553 of title 5, United States Code, as determined by the Secretary.

(b) USE OF EXISTING REGULATIONS.—In implementing any provision of this title, the Secretary may, in the discretion of the Secretary, provide for the use of existing regulations to the extent appropriate, without rulemaking.

Subtitle A—FHA Single Family and Multifamily Housing

SEC. 211. AUTHORIZATION TO IMMEDIATELY SUSPEND MORTGAGEES.

Section 202(c)(3)(C) of the National Housing Act (12 U.S.C. 1708(c)(3)(C)) is amended by inserting after the first sentence the following new sentence: "Notwithstanding paragraph (4)(A), a suspension shall be effective upon issuance by the Board if the Board determines that there exists adequate evidence that immediate action is required to protect the financial interests of the Department or the public.".

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SEC. 212. EXTENSION OF EQUITY SKIMMING TO OTHER SINGLE FAMILY AND MULTIFAMILY HOUSING PROGRAMS.

Section 254 of the National Housing Act (12 U.S.C. 1715z–19) is amended to read as follows:

"SEC. 254. EQUITY SKIMMING PENALTY.

"(a) IN GENERAL.—Whoever, as an owner, agent, or manager, or who is otherwise in custody, control, or possession of a multifamily project or a 1- to 4-family residence that is security for a mortgage note that is described in subsection (b), willfully uses or authorizes the use of any part of the rents, assets, proceeds, income, or other funds derived from property covered by that mortgage note for any purpose other than to meet reasonable and necessary expenses that include expenses approved by the Secretary if such approval is required, in a period during which the mortgage note is in default or the project is in a nonsurplus cash position, as defined by the regulatory agreement covering the property, or the mortgagor has failed to comply with the provisions of such other form of regulatory control imposed by the Secretary, shall be fined not more than $500,000, imprisoned not more than 5 years, or both.

"(b) MORTGAGE NOTES DESCRIBED.—For purposes of subsection (a), a mortgage note is described in this subsection if it—

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"(1) is insured, acquired, or held by the Secretary pursuant to this Act;

"(2) is made pursuant to section 202 of the Housing Act of 1959 (including property still subject to section 202 program requirements that existed before the date of enactment of the Cranston-Gonzalez National Affordable Housing Act); or

"(3) is insured or held pursuant to section 542 of the Housing and Community Development Act of 1992, but is not reinsured under section 542 of the Housing and Community Development Act of 1992.".

SEC. 213. CIVIL MONEY PENALTIES AGAINST MORTGAGEES, LENDERS, AND OTHER PARTICIPANTS IN FHA PROGRAMS.

(a) CHANGE TO SECTION TITLE.—Section 536 of the National Housing Act (12 U.S.C. 1735f–14) is amended by striking the section heading and the section designation and inserting the following:

"SEC. 536. CIVIL MONEY PENALTIES AGAINST MORTGAGEES, LENDERS, AND OTHER PARTICIPANTS IN FHA PROGRAMS.".

(b) EXPANSION OF PERSONS ELIGIBLE FOR PENALTY.—Section 536(a) of the National Housing Act (12 U.S.C. 1735f–14(a)) is amended—

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(1) in paragraph (1), by striking the first sentence and inserting the following: "If a mortgagee approved under the Act, a lender holding a contract of insurance under title I of this Act, or a principal, officer, or employee of such mortgagee or lender, or other person or entity participating in either an insured mortgage or title I loan transaction under this Act or providing assistance to the borrower in connection with any such loan, including sellers of the real estate involved, borrowers, closing agents, title companies, real estate agents, mortgage brokers, appraisers, loan correspondents and dealers, knowingly and materially violates any applicable provision of subsection (b), the Secretary may impose a civil money penalty on the mortgagee or lender, or such other person or entity, in accordance with this section. The penalty under this paragraph shall be in addition to any other available civil remedy or any available criminal penalty, and may be imposed whether or not the Secretary imposes other administrative sanctions."; and

(2) in paragraph (2)—

(A) in the first sentence, by inserting "or such other person or entity" after "lender"; and

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(B) in the second sentence, by striking "provision" and inserting "the provisions".

(c) ADDITIONAL VIOLATIONS FOR MORTGAGEES, LENDERS, AND OTHER PARTICIPANTS IN FHA PROGRAMS.—Section 536(b) of the National Housing Act (12 U.S.C. 1735f–14(b)) is amended—

(1) by redesignating paragraph (2) as paragraph (3);

(2) by inserting after paragraph (1) the following new paragraph:

"(2) The Secretary may impose a civil money penalty under subsection (a) for any knowing and material violation by a principal, officer, or employee of a mortgagee or lender, or other participants in either an insured mortgage or title I loan transaction under this Act or provision of assistance to the borrower in connection with any such loan, including sellers of the real estate involved, borrowers, closing agents, title companies, real estate agents, mortgage brokers, appraisers, loan correspondents, and dealers for—

"(A) submission to the Secretary of information that was false, in connection with any mortgage insured under this Act, or any loan

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that is covered by a contract of insurance under title I of this Act;

"(B) falsely certifying to the Secretary or submitting to the Secretary a false certification by another person or entity; or

"(C) failure by a loan correspondent or dealer to submit to the Secretary information which is required by regulations or directives in connection with any loan that is covered by a contract of insurance under title I of this Act."; and

(3) in paragraph (3), as redesignated, by striking "or paragraph (1)(F)" and inserting "or (F), or paragraph (2) (A), (B), or (C)".

(d) CONFORMING AND TECHNICAL AMENDMENTS.—Section 536 of the National Housing Act (12 U.S.C. 1735f–14) is amended—

(1) in subsection (c)(1)(B), by inserting after "lender" the following: "or such other person or entity";

(2) in subsection (d)(1)—

(A) by inserting "or such other person or entity" after "lender"; and

(B) by striking "part 25" and inserting "parts 24 and 25"; and

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(3) in subsection (e), by inserting "or such other person or entity" after "lender" each place that term appears.

Subtitle B—FHA Multifamily

SEC. 220. CIVIL MONEY PENALTIES AGAINST GENERAL PARTNERS, OFFICERS, DIRECTORS, AND CERTAIN MANAGING AGENTS OF MULTIFAMILY PROJECTS.

(a) CIVIL MONEY PENALTIES AGAINST MULTIFAMILY MORTGAGORS.—Section 537 of the National Housing Act (12 U.S.C. 1735f–15) is amended—

(1) in subsection (b)(1), by striking "on that mortgagor" and inserting the following: "on that mortgagor, on a general partner of a partnership mortgagor, or on any officer or director of a corporate mortgagor";

(2) in subsection (c)—

(A) by striking the subsection heading and inserting the following:

"(c) OTHER VIOLATIONS.—"; and

(B) in paragraph (1)—

(i) by striking "VIOLATIONS.—The Secretary may" and all that follows through the colon and inserting the following:

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"(A) LIABLE PARTIES.—The Secretary may also impose a civil money penalty under this section on—

"(i) any mortgagor of a property that includes five or more living units and that has a mortgage insured, coinsured, or held pursuant to this Act;

"(ii) any general partner of a partnership mortgagor of such property;

"(iii) any officer or director of a corporate mortgagor;

"(iv) any agent employed to manage the property that has an identity of interest with the mortgagor, with the general partner of a partnership mortgagor, or with any officer or director of a corporate mortgagor of such property; or

"(v) any member of a limited liability company that is the mortgagor of such property or is the general partner of a limited partnership mortgagor or is a partner of a general partnership mortgagor.

"(B) VIOLATIONS.—A penalty may be imposed under this section upon any liable party

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under subparagraph (A) that knowingly and materially takes any of the following actions:";

(ii) in subparagraph (B), as designated by clause (i), by redesignating the subparagraph designations (A) through (L) as clauses (i) through (xii), respectively;

(iii) by adding after clause (xii), as redesignated by clause (ii), the following new clauses:

"(xiii) Failure to maintain the premises, accommodations, any living unit in the project, and the grounds and equipment appurtenant thereto in good repair and condition in accordance with regulations and requirements of the Secretary, except that nothing in this clause shall have the effect of altering the provisions of an existing regulatory agreement or federally insured mortgage on the property.

"(xiv) Failure, by a mortgagor, a general partner of a partnership mortgagor, or an officer or director of a corporate mortgagor, to provide management for the project that is acceptable to the Secretary

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pursuant to regulations and requirements of the Secretary."; and

(iv) in the last sentence, by deleting "of such agreement" and inserting "of this subsection";

(3) in subsection (d)—

(A) in paragraph (1)(B), by inserting after "mortgagor" the following: ", general partner of a partnership mortgagor, officer or director of a corporate mortgagor, or identity of interest agent employed to manage the property"; and

(B) by adding at the end the following new paragraph:

"(5) PAYMENT OF PENALTY.—No payment of a civil money penalty levied under this section shall be payable out of project income.";

(4) in subsection (e)(1), by deleting "a mortgagor" and inserting "an entity or person";

(5) in subsection (f), by inserting after "mortgagor" each place such term appears the following: ", general partner of a partnership mortgagor, officer or director of a corporate mortgagor, or identity of interest agent employed to manage the property";

(6) by striking the heading of subsection (f) and inserting the following: "CIVIL MONEY PEN-

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ALTIES AGAINST MULTIFAMILY MORTGAGORS, GENERAL PARTNERS OF PARTNERSHIP MORTGAGORS, OFFICERS AND DIRECTORS OF CORPORATE MORTGAGORS, AND CERTAIN MANAGING AGENTS"; and

(7) by adding at the end the following new subsection:

"(k) IDENTITY OF INTEREST MANAGING AGENT.—For purposes of this section, the terms 'agent employed to manage the property that has an identity of interest' and 'identity of interest agent' mean an entity—

"(1) that has management responsibility for a project;

"(2) in which the ownership entity, including its general partner or partners (if applicable) and its officers or directors (if applicable), has an ownership interest; and

"(3) over which the ownership entity exerts effective control.".

(b) IMPLEMENTATION.—

(1) PUBLIC COMMENT.—The Secretary shall implement the amendments made by this section by regulation issued after notice and opportunity for public comment. The notice shall seek comments primarily as to the definitions of the terms "ownership interest in" and "effective control", as those terms

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are used in the definition of the terms "agent employed to manage the property that has an identity of interest" and "identity of interest agent".

(2) TIMING.—A proposed rule implementing the amendments made by this section shall be published not later than one year after the date of enactment of this Act.

(c) APPLICABILITY OF AMENDMENTS.—The amendments made by subsection (a) shall apply only with respect to—

(1) violations that occur on or after the effective date of the final regulations implementing the amendments made by this section; and

(2) in the case of a continuing violation (as determined by the Secretary of Housing and Urban Development), any portion of a violation that occurs on or after that date.

SEC. 221. CIVIL MONEY PENALTIES FOR NONCOMPLIANCE WITH SECTION 8 HAP CONTRACTS.

(a) BASIC AUTHORITY.—Title I of the United States Housing Act of 1937 is amended by adding at the end the following new section:

"SEC. 27. CIVIL MONEY PENALTIES AGAINST SECTION 8 OWNERS.

"(a) IN GENERAL.—

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"(1) EFFECT ON OTHER REMEDIES.—The penalties set forth in this section shall be in addition to any other available civil remedy or any available criminal penalty, and may be imposed regardless of whether the Secretary imposes other administrative sanctions.

"(2) FAILURE OF SECRETARY.—The Secretary may not impose penalties under this section for a violation, if a material cause of the violation is the failure of the Secretary, an agent of the Secretary, or a public housing agency to comply with an existing agreement.

"(b) VIOLATIONS OF HOUSING ASSISTANCE PAYMENT CONTRACTS FOR WHICH PENALTY MAY BE IMPOSED.—

"(1) LIABLE PARTIES.—The Secretary may impose a civil money penalty under this section on—

"(A) any owner of a property receiving project-based assistance under section 8;

"(B) any general partner of a partnership owner of that property; and

"(C) any agent employed to manage the property that has an identity of interest with the owner or the general partner of a partnership owner of the property.

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"(2) VIOLATIONS.—A penalty may be imposed under this section for a knowing and material breach of a housing assistance payments contract, including the following—

"(A) failure to provide decent, safe, and sanitary housing pursuant to section 8; or

"(B) knowing or willful submission of false, fictitious, or fraudulent statements or requests for housing assistance payments to the Secretary or to any department or agency of the United States.

"(3) AMOUNT OF PENALTY.—The amount of a penalty imposed for a violation under this subsection, as determined by the Secretary, may not exceed $25,000 per violation.

"(c) AGENCY PROCEDURES.—

"(1) ESTABLISHMENT.—The Secretary shall issue regulations establishing standards and procedures governing the imposition of civil money penalties under subsection (b). These standards and procedures—

"(A) shall provide for the Secretary or other department official to make the determination to impose the penalty;

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"(B) shall provide for the imposition of a penalty only after the liable party has received notice and the opportunity for a hearing on the record; and

"(C) may provide for review by the Secretary of any determination or order, or interlocutory ruling, arising from a hearing and judicial review, as provided under subsection (d).

"(2) FINAL ORDERS.—

"(A) IN GENERAL.—If a hearing is not requested before the expiration of the 15-day period beginning on the date on which the notice of opportunity for hearing is received, the imposition of a penalty under subsection (b) shall constitute a final and unappealable determination.

"(B) EFFECT OF REVIEW.—If the Secretary reviews the determination or order, the Secretary may affirm, modify, or reverse that determination or order.

"(C) FAILURE TO REVIEW.—If the Secretary does not review that determination or order before the expiration of the 90-day period beginning on the date on which the determina-

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tion or order is issued, the determination or order shall be final.

"(3) FACTORS IN DETERMINING AMOUNT OF PENALTY.—In determining the amount of a penalty under subsection (b), the Secretary shall take into consideration—

"(A) the gravity of the offense;

"(B) any history of prior offenses by the violator (including offenses occurring before the enactment of this section);

"(C) the ability of the violator to pay the penalty;

"(D) any injury to tenants;

"(E) any injury to the public;

"(F) any benefits received by the violator as a result of the violation;

"(G) deterrence of future violations; and

"(H) such other factors as the Secretary may establish by regulation.

"(4) PAYMENT OF PENALTY.—No payment of a civil money penalty levied under this section shall be payable out of project income.

"(d) JUDICIAL REVIEW OF AGENCY DETERMINATION.—Judicial review of determinations made under this

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section shall be carried out in accordance with section 537(c) of the National Housing Act.

"(e) REMEDIES FOR NONCOMPLIANCE.—

"(1) JUDICIAL INTERVENTION.—

"(A) IN GENERAL.—If a person or entity fails to comply with the determination or order of the Secretary imposing a civil money penalty under subsection (b), after the determination or order is no longer subject to review as provided by subsections (c) and (d), the Secretary may request the Attorney General of the United States to bring an action in an appropriate United States district court to obtain a monetary judgment against that person or entity and such other relief as may be available.

"(B) FEES AND EXPENSES.—Any monetary judgment awarded in an action brought under this paragraph may, in the discretion of the court, include the attorney's fees and other expenses incurred by the United States in connection with the action.

"(2) NONREVIEWABILITY OF DETERMINATION OR ORDER.—In an action under this subsection, the validity and appropriateness of the determination or

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order of the Secretary imposing the penalty shall not be subject to review.

"(f) SETTLEMENT BY SECRETARY.—The Secretary may compromise, modify, or remit any civil money penalty which may be, or has been, imposed under this section.

"(g) DEPOSIT OF PENALTIES.—

"(1) IN GENERAL.—Notwithstanding any other provision of law, if the mortgage covering the property receiving assistance under section 8 is insured or formerly insured by the Secretary, the Secretary shall apply all civil money penalties collected under this section to the appropriate insurance fund or funds established under this Act, as determined by the Secretary.

"(2) EXCEPTION.—Notwithstanding any other provision of law, if the mortgage covering the property receiving assistance under section 8 is neither insured nor formerly insured by the Secretary, the Secretary shall make all civil money penalties collected under this section available for use by the appropriate office within the Department for administrative costs related to enforcement of the requirements of the various programs administered by the Secretary.

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"(h) DEFINITIONS.—For the purposes of this section—

"(1) the term 'agent employed to manage the property that has an identity of interest' means an entity—

"(A) that has management responsibility for a project;

"(B) in which the ownership entity, including its general partner or partners (if applicable), has an ownership interest; and

"(C) over which such ownership entity exerts effective control; and

"(2) the term 'knowing' means having actual knowledge of or acting with deliberate ignorance of or reckless disregard for the prohibitions under this section.".

(b) APPLICABILITY.—The amendments made by subsection (a) shall apply only with respect to—

(1) violations that occur on or after the effective date of final regulations implementing the amendments made by this section; and

(2) in the case of a continuing violation (as determined by the Secretary of Housing and Urban Development), any portion of a violation that occurs on or after such date.

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(c) IMPLEMENTATION.—

(1) REGULATIONS.—

(A) IN GENERAL.—The Secretary shall implement the amendments made by this section by regulation issued after notice and opportunity for public comment.

(B) COMMENTS SOUGHT.—The notice under subparagraph (A) shall seek comments as to the definitions of the terms "ownership interest in" and "effective control", as such terms are used in the definition of the term "agent employed to manage such property that has an identity of interest".

(2) TIMING.—A proposed rule implementing the amendments made by this section shall be published not later than one year after the date of enactment of this Act.

SEC. 222. EXTENSION OF DOUBLE DAMAGES REMEDY.

Section 421 of the Housing and Community Development Act of 1987 (12 U.S.C. 1715z–4a) is amended—

(1) in subsection (a)(1)—

(A) in the first sentence, by striking "Act; or (B)" and inserting the following: "Act; (B) a regulatory agreement that applies to a multifamily project whose mortgage is insured or

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held by the Secretary under section 202 of the Housing Act of 1959 (including property subject to section 202 of such Act as it existed before enactment of the Cranston-Gonzalez National Affordable Housing Act of 1990); (C) a regulatory agreement or such other form of regulatory control as may be imposed by the Secretary that applies to mortgages insured or held by the Secretary under section 542 of the Housing and Community Development Act of 1992, but not reinsured under section 542 of the Housing and Community Development Act of 1992; or (D)"; and

(B) in the second sentence, by inserting after "agreement" the following: ", or such other form of regulatory control as may be imposed by the Secretary,";

(2) in subsection (a)(2), by inserting after "Act," the following: "under section 202 of the Housing Act of 1959 (including section 202 of such Act as it existed before enactment of the Cranston-Gonzalez National Affordable Housing Act of 1990) and under section 542 of the Housing and Community Development Act of 1992,";

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(3) in subsection (b), by inserting after "agreement" the following: ", or such other form of regulatory control as may be imposed by the Secretary,";

(4) in subsection (c)—

(A) in the first sentence, by inserting after "agreement" the following: ", or such other form of regulatory control as may be imposed by the Secretary,"; and

(B) in the second sentence, by inserting before the period the following: "or under the Housing Act of 1959, as appropriate"; and

(5) in subsection (d), by inserting after "agreement" the following: ", or such other form of regulatory control as may be imposed by the Secretary,".

SEC. 223. OBSTRUCTION OF FEDERAL AUDITS.

Section 1516(a) of title 18, United States Code, is amended by inserting after "under a contract or subcontract," the following: "or relating to any property that is security for a mortgage note that is insured, guaranteed, acquired, or held by the Secretary of Housing and Urban Development pursuant to any Act administered by the Secretary,".

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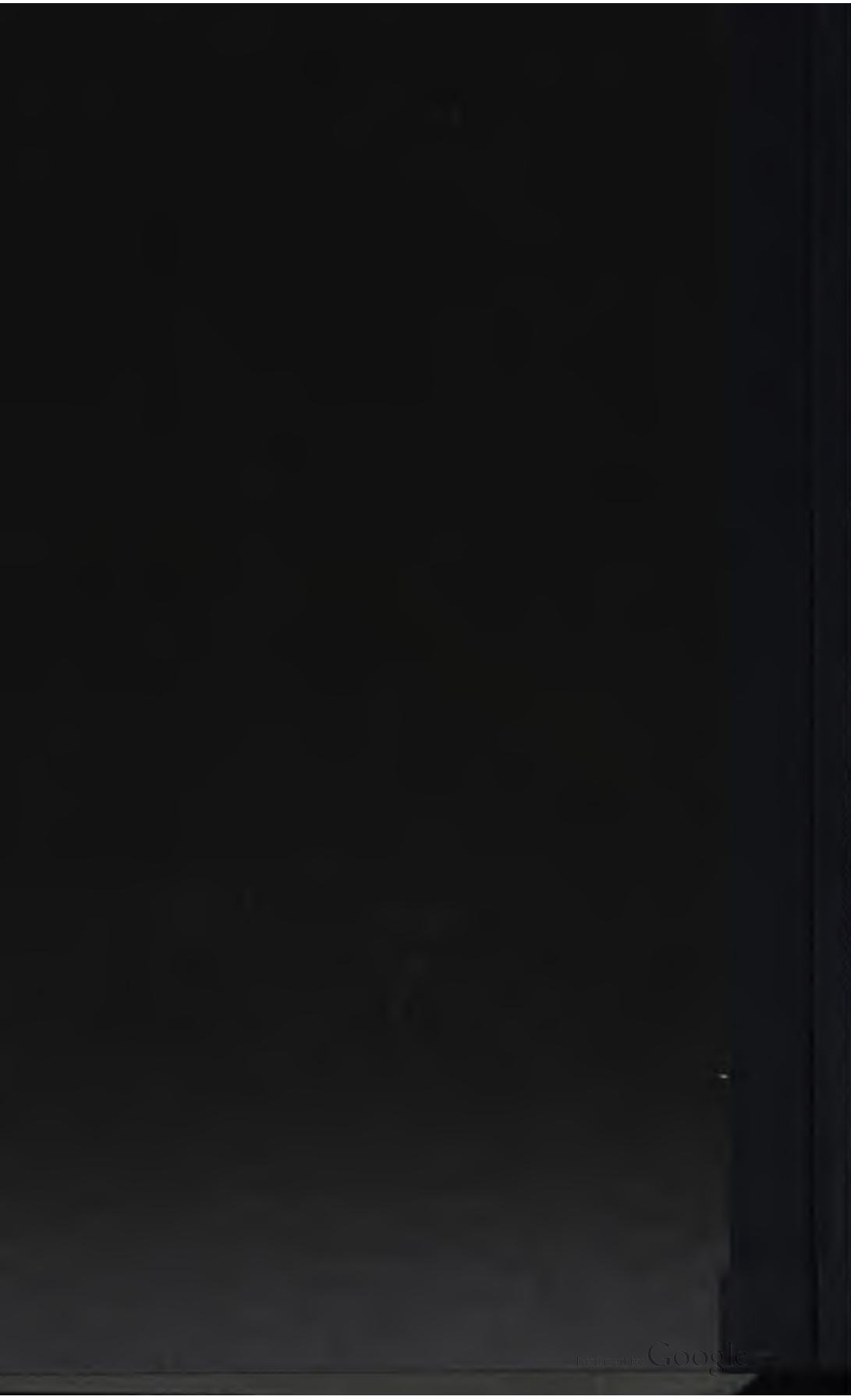
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